RESTRICTIVE TRADE PRACTICES COMMISSION

# REPORT

Transmitting a Study of Certain Discriminatory Pricing Practices in the Grocery Trade made by the Director of Investigation and Research

DEPARTMENT OF JUSTICE
OTTAWA

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Department of Justice
Ottawa
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RESTRICTIVE TRADE PRACTICES COMMISSION

C. Rhodes Smith, Q.C., M.A., LL.B., B.C.L.
Chairman

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Member

RESTRICTIVE TRADE PRACTICES COMMISSION

Ottawa

December 9, 1958

Honourable E. Davie Fulton, P.C., Q.C., M.P.,
Minister of Justice,
Ottawa.

Sir:

I have the honour to submit to you herewith the report of the Restrictive Trade Practices Commission, arising out of a general inquiry made by the Director of Investigation and Research under Section 42 of the Combines Investigation Act into the subject of certain discriminatory pricing practices in the grocery trade.

For reasons which are set out in the report the Commission has not considered it necessary to continue the inquiry beyond the stage of the Statement submitted to the Commission by the Director and, accordingly, we are including the Director's Statement as Part II of the report.

Yours faithfully,

(Sgd.) C. Rhodes Smith

C. Rhodes Smith
Chairman

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### PART II

Material Collected [by the Director of Investigation and Research] for Submission to the Restrictive Trade Practices Commission in the Course of an Inquiry under Section 42 of the Combines Investigation Act into Certain Discriminatory Pricing Practices in the Grocery Trade

# REPORT TRANSMITTING A STUDY OF CERTAIN DISCRIMINATORY PRICING PRACTICES IN THE GROCERY TRADE MADE BY THE DIRECTOR OF INVESTIGATION AND RESEARCH

## PART I

### Origin and Nature of the Inquiry made by the Director of Investigation and Research

Section 42(1) of the Combines Investigation Act provides authority for the Director of Investigation and Research to conduct what are sometimes referred to as "general inquiries" into conditions or practices which appear to be related to monopolistic situations or restraint of trade in connection with any commodity. In the course of an earlier general inquiry into "loss-leader" selling* a number of those who made representations placed emphasis upon differential prices from suppliers as a major factor in creating competitive difficulties for small retailers. Complaints of a similar nature continued to be received by the Director, and, in addition the Director received complaints of alleged demands on manufacturers for advertising, display and promotion allowances and for various kinds of special deals, in order to secure effective promotional support of the manufacturers' branded products in chain stores and member stores of co-operative groups. In describing the initiation of the inquiry the Director states:

> "In view of the number of complaints received and the obvious importance of the issues raised, an inquiry was undertaken into the nature and extent of the price differentials and other buying terms available to different buyers. A number of questionnaires was circulated to suppliers and chain stores to elicit information on various aspects of discount structures and special discounts and allowances."

---

* <u>Report on an Inquiry into Loss-Leader Selling</u>, (Department of Justice, Ottawa, 1955).

The inquiry made by the Director has been directed with particular attention to the distribution of grocery products for the following reasons, as stated by the Director:

> "First, the complaints received tended to concentrate in this field. Second, the process of obtaining replies to questionnaires proved to be so time-consuming - this was notably the case for the questionnaire on special discounts and allowances which was sent to some 550 firms in the grocery field - that it is considered desirable to make the material obtained available without further delay. Finally, the issues which were raised by complainants in wholesale and retail trade in the grocery field were in many respects the same as those raised by complainants, primarily retailers and wholesalers, in other fields; hence the analysis that follows will deal with general problems that are common to a number of fields even though the problems may differ in magnitude and in detail from field to field."

## Scope of Material Compiled by the Director and Submitted to the Commission

In June, 1958 the Director submitted to the Commission a volume of more than 200 pages consisting of analyses of the replies to the various questionnaires which had been sent out during the inquiry, together with certain background material relating to the legislative history of the price discrimination section of the Combines Investigation Act and economic writings on the subject of price discrimination.

The volume submitted to the Commission by the Director has been entitled:

> "Material Collected for Submission to the Restrictive Trade Practices Commission in the Course of an Inquiry under Section 42 of the Combines Investigation Act into Certain Discriminatory Pricing Practices in the Grocery Trade."

The following statement is made in the Preface to the volume:

> "To avoid misunderstanding, it is emphasized that this is not a Report under the Combines Investigation Act. It is material collected and analysed for the purpose of being laid

before the Restrictive Trade Practices Commission in connection with an inquiry, under Section 42 of the Act, into the practice of price discrimination - or, more properly, a group of practices involving price discrimination in the grocery trades. The word 'discrimination' is used in this Preface in the sense of differentiation among different customers or classes of customers and without necessarily implying an unwarranted or unjustified differentiation. The Commission is required by the Act 'to consider any evidence or material brought before it [for the purposes of such an inquiry] together with such further evidence or material as the Commission considers advisable and to report thereon in writing to the Minister.' Such report is a report under the Act, but a report of a general character to be distinguished from a report concerning an inquiry into alleged or suspected contraventions."

The results of the inquiry, embodied in the volume submitted to the Commission, may be described as an economic study of price discrimination which had been made by Dr. L.A. Skeoch, then one of the senior officers on the staff of the Director, now Associate Professor of Economics at Queen's University.

As the Statement submitted by the Director is made part of this report it is not necessary to attempt a summary of its contents. It will be sufficient to indicate the general scope of the study by reference to the subjects of the chapters. The first chapter describes the origins of the inquiry and gives a general review of Canadian legislation on price discrimination. This is supplemented by an appendix containing extracts from the Report of the Royal Commission on Price Spreads (1935) which formed the basis for the legislation on price discrimination first enacted in 1935. Chapter 2 is an economic analysis of price discrimination and contains references to the writings and theories of a number of leading economists. In Chapter 3 an examination is made of the structure of the grocery trade in Canada, and the positions occupied by wholesale grocers, chain stores, voluntary chains and independent retailers are analyzed. Chapter 4 deals with discount structures, which embrace trade discounts, quantity discounts and cumulative or volume discounts, and describes the positions of various classes of buyers in relation to terms of discount. Special discounts and allowances are analyzed in Chapter 5. For purposes of the inquiry, special discounts and allowances were defined as "all those forms of discount and allowance which do not appear on the face of the invoice". The information

forming the basis of this chapter was derived from replies to questionnaires sent to the 14 principal chain store organizations in Canada and to 557 suppliers of grocery products. Chapter 6 contains the results of a special survey of discounts and allowances applying to a group of grocery products delivered to warehouses of distributors in the metropolitan Toronto area. Chapter 7 contains a review of individual replies to the questionnaire on special discounts and allowances and indicates the nature of some of the advertising and promotional arrangements for which special discounts and allowances are made by suppliers. This chapter also gives some examples of high rates of special discounts and allowances and points to the desirability of review by manufacturers of their price structures to avoid the possibility of discriminatory practices of a kind not warranted on economic grounds and which work unfair hardship on certain types of dealers. The latter point is elaborated in the final chapter of the study in which the conclusion is presented that the major source of differential treatment of grocery distributors appears to be found in special discounts and allowances.

## Steps Taken by the Restrictive Trade Practices Commission to Invite Submissions and Comments on the Study of Discriminatory Pricing Practices

While the statistical information presented in the Director's Statement relates to the grocery field, the economic analysis of price discrimination which forms a substantial part of the study as well as the general conclusions seemed to the Commission to justify inviting representations and comments from other fields of trade and industry in addition to those which had been most directly involved in the inquiry.

During August, 1958 the Restrictive Trade Practices Commission sent letters to more than 800 individuals, business firms and organizations, including the more than 500 firms in the grocery field from whom information had been requested by the Director in the inquiry, enclosing a copy of the Statement received from the Director and inviting representations on the facts and material contained in the study of discriminatory pricing practices. Notice that the Commission was interested in receiving comments on the Director's Statement was given in the same way to trade associations of retailers, wholesalers and manufacturers in the grocery field, and also to trade associations in other fields who the Commission thought might be interested in the general aspects of the inquiry. Letters were also sent to chain stores and to co-operative and consumer organizations. The Commission's letter

to trade associations and co-operatives read as follows:

"In the Matter of an Inquiry under Section 42
of the Combines Investigation Act into
Discriminatory Pricing Practices

Dear Sir:

The Restrictive Trade Practices Commission has received from the Director of Investigation and Research under the Combines Investigation Act a statement of the facts and information obtained by him in a general inquiry under Section 42 of the Act into the practice discrimination, or, more properly, into a group of practices involving price discrimination in the grocery trades. The Director has pointed out that the word 'discrimination' indicates differentiation among different customers or classes of customers without necessarily implying an unwarranted or unjustified differentiation.

A copy of the Statement submitted to the Commission by the Director is enclosed.

It is now the function of the Commission to consider this Statement, together with such other evidence and material as it may obtain and report thereon to the Minister of Justice.

While the material collected by the Director relates more particularly to the grocery field, it is likely that somewhat similar situations and practices are to be found in other fields of trade. For this reason the Commission is forwarding a copy of the Director's Statement to Trade Associations and Co-Operatives in the grocery field and other fields of commerce. The Commission considers that you or your organization may desire to comment upon the facts and materials contained in the Director's Statement.

If, after considering the subject matter of the inquiry and the conclusions reached by the Director, you are of the opinion that you will wish to present a written brief or make submissions to the Commission in connection with this inquiry, will you so inform the Commission at the earliest possible date, indicating at the same time when you believe your written representations will be ready for submission to the Commission.

Only one copy of the Statement submitted by the Director in the inquiry is being sent at this time. However, if you

intend to make written representations and find that one copy of the Statement will be insufficient the Commission will endeavour to furnish an additional copy or copies on request."

In view of the fact that the Statement submitted to the Commission by the Director was essentially an economic study, copies of the Director's Statement were sent by the Commission to Departments of Economics in universities across Canada and members of the Departments were invited to submit comments from an economic point of view on the material contained in the study. While a number of economists expressed interest in the study the Commission has not received any analytical replies in response to its invitation.

On September 4, 1958 the Commission met informally in Ottawa with representatives of the Canadian Wholesale Council, the Retail Merchants Association of Canada, the Canadian Retail Hardware Association, the Canadian Pharmaceutical Association and the Canadian Wholesale Tobacco and Confectionery Association, when the Commission's interest in receiving additional information in regard to practices of price discrimination and comments on the material contained in the Director's Statement was again emphasized.

The circulation by the Commission of the Statement on Discriminatory Pricing Practices in the extensive manner already described created a great deal of interest and the Commission received many requests for additional copies of the study for members of trade associations and others. Various trade journals reported that the Director had submitted material on discriminatory pricing practices to the Commission and referred to the Commission's desire to receive additional information and comments. Knowledge of the inquiry into discriminatory pricing practices in the grocery trade thus became very widespread in trade circles.

## Results of Commission's Efforts to Secure Comments on the Director's Statement

Although, as already indicated, the Commission found that trade groups and business firms have a great deal of interest in the material compiled by the Director relating to discriminatory pricing practices, no trade organization or business firm has made any submission or representation to the Commission in regard to the Statement. The only observations which the Commission has

received from business firms in regard to the Director's Statement have indicated a favourable appreciation of the manner in which the inquiry has been conducted. A letter from a national bakery stated, "a great deal of painstaking work has been done", and in a letter from a national chain store company the study of discriminatory pricing practices was referred to as "excellent".

The fact that in spite of the widespread invitations which the Commission gave to individuals, business firms, trade groups and others no submissions have been made on any point of the study made by the Director leads to the conclusion that it is considered in the various fields of trade that the material compiled by the Director is sound in its factual aspects and that due regard should be given to the qualified conclusions of the Director based on the information collected.

In the absence of representations to the Commission pointing either to the need or desirability of adding to the factual information collected by the Director or of investigating other aspects of the subject of discriminatory pricing practices, it does not appear necessary for the Commission to pursue the inquiry further at this time. In reaching this conclusion the Commission has also taken account of the fact that no requests or proposals have been made to the Commission for consideration to be given to any aspect of the administration of the legislation relating to price discrimination.

The only organization which submitted representations in response to the Commission's invitation has been the Canadian Association of Consumers. The Association expressed commendation of the study of discriminatory pricing practices and described the Statement prepared by the Director as a detailed and comprehensive survey. In its submission the Canadian Association of Consumers referred particularly to the material relating to advertising and promotional allowances. Such allowances, in the opinion of the Association, might encourage extravagant and sensational promotions and lead to some displacement of competition based on quality and price.

One association of manufacturers in a non-grocery field, and one member company advised the Commission that in their opinion consideration should be given to the repeal of legislation dealing with price discrimination, but no submissions were made with respect to the pricing practices which were the subject matter of the inquiry.

In view of the interest which has been displayed by

business firms, trade groups and others in the Statement on Discriminatory Pricing Practices in the Grocery Trade and the favourable manner in which the Statement has been received, it appears to be the general opinion in all quarters that a comprehensive and valuable study has been made by the Director. Although the Statement has been widely circulated by the Commission it can serve a very useful purpose if made available to the public generally and particularly to all firms which are concerned, either as sellers or buyers, in pricing practices which may involve elements of price discrimination.

The Commission, therefore, transmits as Part II of this report the Statement of the Director relating to Certain Discriminatory Pricing Practices in the Grocery Trade.

(Sgd.) C.R. Smith
Chairman

(Sgd.) A.S. Whiteley
Member

Ottawa,
December 9, 1958.

PART II

Material Collected for Submission to
the Restrictive Trade Practices Commission in
the Course of an Inquiry under Section 42 of
the Combines Investigation Act

into certain

# DISCRIMINATORY PRICING PRACTICES

in the Grocery Trade

Department of Justice
Ottawa
1958

## PREFACE

To avoid misunderstanding, it is emphasized that this is not a Report under the Combines Investigation Act. It is material collected and analysed for the purpose of being laid before the Restrictive Trade Practices Commission in connection with an inquiry, under Section 42 of the Act, into the practice of price discrimination - or, more properly, a group of practices involving price discrimination in the grocery trades. The word "discrimination" is used in this Preface in the sense of differentiation among different customers or classes of customers and without necessarily implying an unwarranted or unjustified differentiation. The Commission is required by the Act "to consider any evidence or material brought before it [for the purposes of such an inquiry] together with such further evidence or material as the Commission considers advisable and to report thereon in writing to the Minister". Such report is a report under the Act, but a report of a general character to be distinguished from a report concerning an inquiry into alleged or suspected contraventions.

All forms of discrimination are not dealt with in detail in the material included. Price discrimination, in fact, covers a wide range of practices from such matters as discount structures, through zone price systems, to predatory pricing, and it would obviously not be possible to undertake a factual analysis of all such situations within the scope of a single study. In the present case, the factual data relate, as has been indicated, to the buying terms and related special discounts and allowances in the field of grocery distribution. However, to provide a basis for evaluating these data, and putting them in perspective, an appendix has been included (Appendix I on the background of the Canadian legislation and a chapter (Chapter 2) on the economic analysis of price discrimination. Parts of Chapter 2 are somewhat technical and will be of most direct interest to those who have devoted some study to this aspect of economics. It is hoped, nevertheless, that parts of Chapter 2, particularly the sections headed, "Definition of Price Discrimination", "The Economic Meaning of Price Discrimination" and "The Big Buyer" will also be of interest to the general reader. The reader who wishes to go directly to the factual data collected in the course of the inquiry will find it in Chapters 4, 5, 6 and 7.

The collection of the material on prices and on special discounts and allowances from more than five hundred suppliers and from the major chain stores took up a great deal of time. This was almost entirely due, not to any reluctance on the part of individual firms to provide the data requested in the questionnaires, but to the fact that laborious analysis of business records was often necessary to obtain the data. It is a pleasure to acknowledge the valuable assistance and the high degree of co-operation received from almost all the firms involved. The executives of a number of leading firms in the grocery field served as consultants in the formulation of the questionnaires, and to them a special expression of thanks is due.

This study is the work of Dr. L.A. Skeoch, one of the senior officers on the staff of the Director under the Combines Investigation Act.

(Sgd.) T. D. MacDonald

T. D. MacDonald
Director of Investigation and Research
Combines Investigation Act

Ottawa, Ontario
2 July, 1958

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# CHAPTER I

## INTRODUCTION

In the course of the inquiry into "loss-leader" selling* it was emphasized by a number of those who made representations that the major factor accounting for their difficulties was not that their larger competitors sold below the prices at which such competitors actually bought supplies from manufacturers or distributors but that the buying prices available to the large buyer were so much lower than those available to the small buyer that the latter was rendered largely non-competitive. This view was expressed with reference to cigarettes, groceries and electrical appliances, particularly.

The following comments are characteristic.

> A grocer - "Press reports over the past several weeks indicate top level consideration largely with emphasis on 'loss leader' contention which seems to me co-related but not the root of the current discriminating problem. . . .
>
> Loss leaders are not of primary concern to the independent, it's the discrimination at the cost base. . . ."
>
> An appliance dealer - "We are a small store, and have considered your request for approximate data on price cutting.
>
> We would be very glad to furnish you with this data, but we feel that the retail end is not necessarily the source of your problem.
>
> We feel the source is at the manufacturer. They feel justified in giving us 25% or 28 - 1/2% discounts. Then turn around and give large stores 40% to 45% discounts. . . .

---

* Report on an Inquiry into Loss-Leader selling (Department of Justice, Ottawa, 1955).

I have friends who have closed up appliance stores because the large stores can sell at retail and still make a good profit, for the same price that the small dealer pays wholesale for his unit."

An association of retailers - "By virtue of preferential pricing from the manufacturers these outlets [chain stores] have been enabled to profitably retail popular brands of cigarettes at prices which closely correspond to the wholesaler's price for the majority of the independent trade."

Complaints such as these have continued to reach the Director in fairly considerable numbers. At the same time, complaints about the use being made by large buyers of their bargaining power have been received from another quarter. These relate to demands allegedly received by manufacturers for advertising allowances, display and promotion allowances, and various kinds of special deals, if the manufacturers' branded products are to receive effective promotional support in chain stores and member stores of co-operative groups. The following letter to the Director, although indicating some misapprehension as to the significance of section 412 of the Criminal Code, sets out rather fully the nature of the matters that were causing one manufacturer concern:

"Since the government put in force the law 498A [now 412] the large buyers of groceries throughout the country have been scratching their heads to find out what they could receive in the way of remuneration from people like ourselves that the other fellow, or smaller fellow could not get. It has now resulted in an embarrassing position for, if you do not go in on some of the campaigns there is the possibility that your full line will be taken out of the stores.

. . .

I could go on and give you case after case, where it is even worse in my opinion now, than the days when manufacturers such as ourselves gave certain discounts because of volume, to certain accounts who were worthy of it, but now it has reached the point where the chains are battling one another and will continue to do so. But in doing so, they wish the manufacturer to play the tune and we, for one, will not go along with it.

Now in saying this, I am not criticizing one chain over any other for they will all be guilty of this same condition. I would like to know, before making any move, which is the greater sin. To give a cash rebate to a good customer or to give it to them in way of support for a special promotion they may have. Where is the difference?

I am prompted to write you this letter to-day because of a new contest presented to us by a dealer in . . . copy of which I am attaching hereto, and before answering this one way or the other, I realise the sponsor of this contest will look more favourably on those who participate than those who do not.

Now if this continues, I would like it known that we will discontinue all forms of rebate and save our money to go into deals such as this and we will give it to whoever we think is worthy of it. In so doing, I will admit we will be getting back into a worse rut than before law 498A was exercised."

Another manufacturer reported that he had been asked for a shelf-space payment of $75 per week per store by a chain, with the alternative of removing his product from the entire chain. This payment was in addition to the quantity discount customarily granted the chain.

In view of the number of complaints received and the obvious importance of the issues raised, an inquiry was undertaken into the nature and extent of the price differentials and other buying terms available to different buyers. A number of questionnaires was circulated to suppliers and chain stores to elicit information on various aspects of discount structures and special discounts and allowances. These will be reported in detail in later chapters of this statement.

The greater part of the statistical information contained in this statement relates to grocery products. For this there is a number of reasons. First, the complaints received

tended to concentrate in this field.[1] Second, the process of obtaining

---

1. In a recent review of twenty years' experience with the Robinson-Patman Act in the United States, Corwin D. Edwards commented on the distribution of cases across the range of American industry: "The brokerage cases have been overwhelmingly concentrated in the food industries, to which 110 of 127 brokerage proceedings apply. . . ."

"The cases involving violations of other sections of the act have been more widely distributed among industries than the brokerage cases. Thirty-nine of the 115 orders as to such violations have to do with food products; 12 with rubber products; 7 with construction materials; 7 with automotive supplies; 12 with clothing, watches, jewelry, and cosmetics; 7 with medical and dental equipment and drugs; 12 with books, stationery and educational supplies; 5 with industrial equipment and materials; and 14 with miscellaneous commodities . . . ." "Twenty Years of the Robinson-Patman Act," The Journal of Business, The School of Business of the University of Chicago, Vol. XXIX, No. 3, July, 1956, p. 152.

It will be recalled that the major provisions of the Robinson-Patman Act, 1936, are directed against discriminatory practices which injure competition. In very general terms, price differentials on goods of like grade and quality are forbidden where the effect may be "to injure, destroy or prevent competition." , Differentials having such effect may, however, be "justified" on certain grounds: if they are made in good faith to meet competition, if they make only "due allowance" for differences in the cost of manufacture, sale or delivery. The payment of brokerage to an agent or representative "subject to the direct or indirect control" of any party to a purchase or sale is prohibited, except for services rendered. The provision of, or payment for, services or facilities - such as advertising or promotional allowances - must be accorded to all purchasers on proportionally equal terms.

replies to questionnaires proved to be so time-consuming - this was notably the case for the questionnaire on special discounts and allowances which was sent to some 550 firms in the grocery field - that it is considered desirable to make the material obtained available without further delay. Finally, the issues which were raised by complainants in wholesale and retail trade in the grocery field were in many respects the same as those raised by complainants, primarily retailers and wholesalers, in other fields; hence the analysis that follows will deal with general problems that are common to a number of fields even though the problems may differ in magnitude and in detail from field to field.

A chapter has been included on the general economic aspects of price discrimination. This is not intended to provide an exhaustive analysis of the theory and practice of price discrimination but rather to indicate something of the range and complexity of the factors involved in discriminatory situations. Distribution, retail and wholesale, is by no means the only area of the economy in which price discrimination may have a significant impact.

## The Canadian Legislation on Price Discrimination

The legislation relating to price discrimination is contained in Section 412 of the Criminal Code and reads as follows:

"412. (1) Every one engaged in trade, commerce or industry who

(a) is a party or privy to, or assists in, any sale that discriminates to his knowledge, directly or indirectly, against competitors of the purchaser, in that any discount, rebate, allowance, price concession or other advantage, is granted to the purchaser over and above any discount, rebate, allowance, price concession or other advantage, available at the time of such sale to such competitors in respect of a sale of goods of like quality and quantity;

(b) engages in a policy of selling goods in any area of Canada at prices lower than those exacted by such seller elsewhere in Canada, having or designed to have the effect of substantially lessening competition or eliminating a competitor in such part of Canada; or

(c) engages in a policy of selling goods at prices unreasonably low, having or designed to have the effect of substantially lessening competition or eliminating a competitor ,

is guilty of an indictable offence and is liable to imprisonment for two years.

(2) It is not an offence under paragraph (a) of subsection (1) to be a party or privy to, or assist in any sale mentioned therein unless the discount, rebate, allowance, price concession or other advantage was granted as part of a practice of discriminating as described in that paragraph.

(3) The provisions of paragraph (a) of subsection (1) shall not prevent a co-operative society returning to producers or consumers, or a co-operative wholesale society returning to its constituent retail members, the whole or any part of the net surplus made in its trading operations in proportion to purchases made from or sales to the society."

This section, prior to the renumbering of the sections of the Criminal Code in 1954, was known as 498A. That section was first enacted in 1935 as a result of investigations carried out by the Select Special Committee and the Royal Commission on Price Spreads, which submitted its report on April 9, 1935. This section has remained as it was originally enacted with the exceptions that in 1952 it was amended by adding sub-section (2) so as to make it clear that paragraph (a) of sub-section (1), which relates to unfair and discriminatory price concessions, is directed against a course of action and does not prevent a supplier from meeting spot competition from another supplier offering a better price to a customer; and paragraph (a) of subsection (1) had the words "price concession or other advantage" added to the words "any discount, rebate or allowance".

It is of interest to note that at the time the bill was before Parliament, the then Minister of Justice, when speaking on second reading, indicated some serious doubts both as to the validity* and the probable effectiveness of the proposed legislation. (See Hansard, May 29, 1935, pp. 3167-68.) However, it was his feeling and the feeling of opposition members that the recommendations of the Royal Commission on Price Spreads should be enacted in order to deal, as effectively as might prove possible, with what was considered by the leading spokesmen of various parties to be a problem of major importance. It should also be noted that although the criticism of the Price Spreads Report was directed against the

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* The constitutional validity of the section has since been established: Reference re Section 498A of the Criminal Code 1936, Supreme Court Reports, 363.

power of the mass buyer, the prohibitions of the legislation apply equally and perhaps even more directly to the seller.

No cases have as yet been tried under this section. The legislation has, however, been the subject of considerable discussion and correspondence between the Director and business firms and organizations. For example, the letter, which is quoted below, was written to one organization of business men in response to an inquiry about year-end discounts and rebates. It should be added that in expressing views upon the interpretation of the legislation the Combines Branch is always careful to maintain the position that it is not a regulatory body and that its opinions must not be regarded as rulings, which only the courts are qualified to give. Nor will the Combines Branch assume the character of a private solicitor for the purpose of advising upon the propriety or otherwise of a particular scheme. Subject to these qualifications, it is the endeavour of the Branch to explain the application of the legislation in such a manner that the inquirer by applying the description to his own circumstances may easily recognize any practices that might be considered contrary to the legislation.

> "I wish to acknowledge receipt of your letter . . . about the application of section 498A of the Criminal Code to year-end bonuses or rebates.
>
> You will appreciate, I know, that the Investigation and Research agency, established under the recent amendments to the Combines Investigation Act, is not in any sense a regulatory body with authority to approve of specific practices; that only the Courts can give an authoritative interpretation; and that, in any event, it would not be possible to express a firm opinion as to a proposed method of operation without a full investigation. Subject to this, I may say however, that providing the basis on which year-end bonuses or rebates are to be granted is made known in advance to all customers of the supplier, and that such bonuses or rebates are available to all such customers on the same basis, that is on sales of goods of like quality and quantity, and provided also, of course, that there is no understanding, agreement or arrangement among different suppliers as to the basis on which such year-end bonuses or rebates are to be granted, I do not think that year-end bonuses or rebates based on aggregate purchases during the year from an individual supplier would, in themselves, necessarily constitute an offence under section 498A of the Criminal Code.

The foregoing does not mean, of course, that every such plan would in my opinion be valid. It is quite possible that a particular plan, by reason of some such factor as lack of any reasonable relationship between rebate rates and quantity of purchases; the grouping of commercially unrelated products; or the taking into consideration of extrinsic factors such as counting a particular article, not itself drawing rebate or bonus for the purpose of arriving at the rate; might in fact so discriminate as to come within the section.

You will understand of course, that my comments are not directed to any question of commercial desirability or undesirability of year-end bonuses or rebates or any particular pattern thereof and have no bearing upon any question that might arise as to the desirability of examining any case or cases for this purpose under the general inquiries section which is section 42".

Appendix I contains material from the Report of the Royal Commission on Price Spreads indicating the origin of section 498A (now 412) of the Criminal Code.

## CHAPTER II

## GENERAL ANALYSIS OF PRICE DISCRIMINATION

### Definitions of Price Discrimination

In its ordinary meaning the term "discrimination" does not necessarily suggest any element of unfairness or of unjust treatment. For example, none of the definitions in the Shorter Oxford English Dictionary (1950) carries such a shade of meaning, and one definition of "discrimination" given is "the faculty of discriminating; the power of observing differences accurately, or of making exact distinctions", which rather emphasizes the quality of recognizing, in a precise way, differences that are not readily apparent. Webster's Unabridged Dictionary, as quoted by Ralph Cassady, Jr.,[1] does however, give a definition which emphasizes the element of unfairness; discrimination, it states, is "a distinction, as in treatment; esp., an unfair or injurious distinction."

Not all distinctions in treatment amount to discrimination, nor do all price differentials amount to price discrimination; indeed where prices are uniform discrimination may exist, as will be explained below. However, in some of the comment that has been made to, or received by, the Director, it is assumed that if seller X grants better buying terms to A than to B, then B suffers from price discrimination and is placed in an inferior competitive position. In a word, any price differential implies price discrimination. Many correspondents take a different view, but the direct identification of a price differential with "unfair" discrimination is not infrequently made.

It is perhaps not difficult to understand the considerations that underlie this attitude. First, it is common knowledge that in many commodity markets the price per unit is the same whether the number of units taken is one, one thousand or ten thousand. Wheat, for example, is sold at a certain price

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1. The Journal of Marketing, Vol. XI, No. 1, July, 1946, p.8.

per bushel in store Fort William - Fort Arthur in units of 1, 000 bushels. Whether the purchase is for one thousand bushels or one million bushels, the price per bushel will be the same if the purchases are made under similar circumstances, that is, for the same grade at the same time, and so on. Not only is the economic efficiency of such markets widely accepted but their "fairness" carries a strong appeal for smaller buyers. Second, the history of the predatory and discriminatory practices of some of the early "trusts" in the United States, which resulted in the elimination of many small competitors and the extorting of large monopoly profits from consumers and producers, is known in a general way to smaller buyers or their trade associations. The undesirable results of these early extreme examples of discriminatory and exploitative behaviour tend to be associated with most forms of price discrimination. In Canada, the monopsonistic behaviour of certain distributing and processing organizations in the 1930's, disclosed by the Price Spreads inquiry, gave, and still gives, further support to the belief in the identity of price differences and price discrimination and in the effects as being necessarily undesirable.

Although these views undoubtedly enjoy some measure of support, and in certain circumstances represent, in part at least, a realistic evaluation of the impact of price discrimination, they obviously fall short of providing an informative basis for analysing the practice.

The Economic Meaning of Price Discrimination

Cassady, in the article already referred to, quotes definitions of price discrimination taken from economic texts and monographs to indicate that they "are far from satisfactory". He says,

> "Thus, Kenneth E. Boulding (Economic Analysis, . . . p. 540) has defined price discrimination as '. . . charging each [buyer] a different price'; Mary Jean Bowman and George Leland Bach (Economic Analysis and Public Policy . . . p. 169), as being 'in a position to charge different prices to different customers . . . '; A.R. Burns (The Decline of Competition . . . p. 273), as selling a '. . . homogeneous commodity at the same time to different purchasers at different prices'; F.A. Fetter, Spahr and others, (Economic Principles and Problems . . . Vol. I, p. 532), as '. . . non-uniform treatment of customers by making a

difference in the price of goods without a corresponding difference in quality, service, or conditions . . . of sale'; F.A. Garver and A.H. Hansen (Principles of Economics . . . p. 190), as charging '. . . different prices for different portions of his output'; J.P. Miller (Unfair Competition . . . p. 122), as '. . . differences or inequalities in price or product'; A.C. Pigou (The Economics of Welfare . . . p. 275), as 'discrimination [sic] of prices as between different customers'; Joan Robinson (The Economics of Imperfect Competition . . . p. 179), as '. . . the act of selling the same article, produced under a single control, at different prices to different buyers . . .'; and F.H. Taussig (Principles of Economics . . . Vol. I, p. 222), as selling '. . . different instalments of the supply . . . at varying prices.' Some writers discuss the subject without even explaining what they mean by the term."

Although these quotations do not do justice in all cases to the meaning as developed by the economists quoted, they do suggest some of the differing aspects of the practice that are emphasized. However, in their present over-condensed form they do little more than this and it may be of greater assistance in clarifying the meaning of price discrimination in economics if a few more extended definitions are reviewed.

Oxenfeldt looks at price discrimination from a rather restricted viewpoint in that he considers it to be "a marketing practice that firms elect or neglect in support of their pricing policy."[1] By way of definition, he says, "Although discrimination usually takes the form of charging different prices on similar transactions, it also occurs when some buyers are favored over others in quality of product or in service. Only differential treatment of individual customers in price, quality, and service not attributable to differences in the cost of taking their business is termed discrimination. Similar treatment of customers whose business involves substantially different costs to the seller therefore is termed discrimination also. "Although in this definition "cost" is not given a precise meaning, it is clear from other sections of the analysis that what is involved is "marginal cost" (roughly, the addition to total cost resulting from the production of an added unit).

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1. Alfred R. Oxenfeldt, Industrial Pricing and Market Practices (New York, 1951), p. 233.

Stigler[1], after tentatively defining price discrimination as "the sale of a commodity at two or more prices", points out that discrimination has a much wider application.

> "We could broaden the concept of discrimination by defining it as the sale of various products at prices which are not proportional to their marginal costs. Then the sale of a book with a 25-cent cover for $3 and with a $1 cover for $6 is an example of discrimination, and we should normally consider this to be discrimination. But so also would be the sale of incandescent lamps and electric generators at different ratios of price to marginal cost be discrimination, and in fact almost every monopolist selling two or more products would be practising price discrimination. The best compromise seems to be to restrict the term, price discrimination, to the sales of technically similar products at prices which are not proportional to marginal costs."

Bain[2] also adds this latter extension of the concept of price discrimination to the simpler version and gives an example that may assist in further clarifying its meaning.

> ". . . when two different goods are yielded from the same production process, with a considerable share of their costs identical but with certain separate added costs for each, their sale at a difference in price which is not proportional to their difference in cost may also be designated as price discrimination. For example, suppose an aluminum producer produces basic ingot at a cost of 15 cents a pound, part of which he turns into roofing at an added cost of 2 cents a pound and part of which he makes into an alloy sheet for aircraft bodies at an added cost of 4 cents a pound. If now he sells roofing at 18 cents a pound and aircraft sheet at 25 cents a pound, he is essentially practising price discrimination."

Even a limited acquaintance with the number of multiple-product firms in existence and the number of products they

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1. George J. Stigler, <u>The Theory of Price</u> (New York, 1952), pp. 214-215.

2. Joe S. Bain, <u>Price Theory</u> (New York, 1952), pp.400-401.

produce[1] would suggest that this "complex" form of discrimination is very common, perhaps more common than the simpler form in which a single firm sells a single product at different prices. It should be added that whatever may be its broader economic significance, the complaints so far received by the Director have not referred to this type of discrimination but have been limited to the charging of different prices for the same (or virtually the same) product-service item.

Bain makes a further extension of the range of price discrimination by calling attention to the fact that although it is customary to analyse discrimination as being practised by a monopolistic seller (or by a collusive oligopoly) with a view to maximizing profit, there is a parallel range of monopsonistic discrimination phenomena related to buying rather than selling prices. On the matter of price discrimination as practised by a buyer, Cassady suggests that even though it might appear that a buyer discriminates each time he acquires the same merchandise from two sources at different prices, in fact discrimination would seem to require that the buyer, not the seller, set the prices. The distinction would, of course, have to extend beyond the mere formality of whether the buyer or the seller made the price offer if the essential features of the price-making influences were to be made clear.

Finally, by way of summary, price discrimination may be defined roughly as: (1) variations in the price of the same product sold under similar conditions to different purchasers; (2) uniform prices charged different purchasers for product-services that are not the same; (3) different prices to different purchasers for different varieties of the same product (or of various technically similar products) if the price differences are not the same as or proportional to the differences in their costs of production. This definition could also be applied, _mutatis mutandis_, to price discrimination on the part of buyers.

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1. "The General Electric Company is said to produce 2,000 products, The Armstrong Cork Company 350, and the B.F. Goodrich Company 32,000. Thorp and Crowder noted that at least half the products made by forty-seven out of fifty of the largest companies accounted each for less than half of 1 per cent of those firms' sales." E.W. Clemens, "Price Discrimination and the Multiple-Product Firm", _The Review of Economic Studies_, 1950-51, Vol. XIX (1), No. 48, p. 1.

Conditions Required for Price Discrimination

The primary prerequisite of price discrimination is, of course, that there should be the power to discriminate. Under conditions of pure competition (a homogeneous product and a large number of sellers) price discrimination would not be possible. Buyers in a market, knowing of the many homogeneous sources of supply, would be indifferent as between the various sellers and would not pay a higher price to one than to any other. The seller would be faced by an infinitely elastic individual demand curve (in other words, he could sell his total output without affecting the prevailing market price) and he would not need to make price concessions in order, for example, to increase his output to the optimum scale. In practice, with the exception of organized commodity exchanges, there may be cases of temporary price discrimination under pure competition during periods of adjustment to changes in cost and in demand.

The basic point is that the power to discriminate rests upon some element of market imperfection. Sellers must enjoy some degree of market power to practice price discrimination, although there need not be "substantial" control of supply, far less anything approaching a position of monopoly. Absence of (or imperfect) knowledge of the terms and conditions on which sales are being made in the market, product differentiation, fewness of sellers, and the like, all would make it possible to practice price discrimination.

Assuming the power to discriminate, it will be advantageous to do so when the market for the product can be separated into parts, or customers can be segregated, so that the seller can increase his profits by charging different prices in the different sub-markets. If the elasticities of demand[1] in the various

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1. Roughly speaking, the elasticity of demand is a measure of the change in the amount purchased in response to a change in price. For example, if the total amount of money spent on the product increases with a decline in price (or decreases with a rise in price), the demand is said to be elastic. If the total amount spent decreases with a decline in price (or increases with a rise in price), the demand is inelastic.

sub-markets are almost the same at relevant prices, then discrimination is without any point. Even where the elasticities of demand are different, the seller must be able to prevent the re-transfer of goods from the lower-priced to the higher-priced sub-market and he must be able to do so at a cost that is not so great as to offset the gain from discrimination. He must also be able to prevent elements of demand from shifting from one sub-market to another. For example, if patients could become poor at will for purposes of medical treatment, doctors could not discriminate by charging higher prices to their rich than to their poor patients. The first condition (different elasticities) is probably fairly common; the condition of non-transferability of supply and demand is less frequently met with.

## General Principles of Discrimination

The seller will, then, try to group buyers according to the elasticity of their demand and he will charge a relatively high price in the sub-market in which demand is less elastic and a lower price in the sub-market in which demand is more elastic, thereby increasing his profit above the level which it would reach if he sold his product at a single price.

A re-statement of this general proposition in less technical terms would run somewhat as follows: if a seller can sub-divide his market into two (or more) groups of buyers such that those in one group are prepared to pay a relatively high price for his product without reducing significantly the amount they purchase, whilst the other group (groups) will buy very little at the high price charged the first group but will be willing to extend the amount purchased very substantially as prices fall to lower levels, the seller may find it will increase his profit to establish separate prices in each sub-market rather than to fix a single price in both markets.

In economic terms the precise technical conditions under which the seller will maximize his profit can be summarized briefly by saying that the marginal revenue[1] in each separable market must be equal (although because of the different elasticities of demand the relation between marginal revenue and price will be different in each sub-market), otherwise it would pay to shift units from one

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1. Roughly, the addition to total revenue from the sale of an added unit.

sub-market to another. In addition, the common marginal revenue must equal marginal cost.

The principles sketched out above are those which apply to what is often called "third-degree discrimination", and it is these that are most commonly referred to in analyses of price discrimination. There are, however, other categories of price discrimination to which brief reference should be made. There is the category that is referred to as "perfect discrimination" or "first-degree price discrimination". Under third-degree discriminatory pricing, different prices are set for different groups of buyers and the individual buyer is free to purchase whatever amount he wishes at the price(s) set. Under first-degree discrimination, the seller attempts to sell each unit at its own particular demand price, that is, he charges each buyer the highest price he will pay for each unit of the goods he receives, with a different price for each such unit. This, as one economist put it, "involves the maximum possible exploitation of each buyer in the interest of the seller's profit. . . ." It should be added that examples of such "perfect discrimination" are difficult to find and it is here referred to for its analytical interest rather than as a practical policy.

Another category of price discrimination sometimes referred to is "chaotic discrimination". This sort of discrimination does not tend to achieve the maximization of sellers' profits. Such discrimination may arise from imperfectly collusive agreement on pricing by oligopolists or from secret price cutting in an oligopolistic setting. An example of the former would be found in various forms of delivered pricing (such as basing-point systems) for industrial products. Uniform delivered prices are sometimes determined on the basis of a formula which involves some greater or lesser degree of discrimination by sellers located at varying distances from buyers (thus involving varying shipping costs). Secondly, sellers may make secret price cuts to some buyers whilst selling to others at published list prices. Such secret concessions are considered to be rather common in industries where there are only a few sellers, since sellers regard them as being less likely to lead to "destructive" price cutting than openly-announced general price reductions. It may be added, by way of anticipating some later discussion, that, considering the setting in which they often take place, such secret price concessions may be the most likely means of bringing about lower prices and profits.

## Common Classifications of Discrimination

There are numerous classifications of price discrimination in addition to that already outlined, which is based essentially on the extent to which and the manner in which profit maximization tends to be realized. Each classification no doubt has its particular value for the purpose for which it was devised and throws light on certain aspects of the practice. For present purposes it may be sufficient to refer to two or three classifications, the first being somewhat more specific than the others.

One of the more common classifications is that including the following groupings:

1. Discrimination between products or between uses of a product: Railways charge relatively low rates on certain commodities such as gravel, lumber and coal, which have small value in proportion to weight and bulk, and relatively high rates on goods of high specific value, such as manufactured consumer goods. Coal, gas, electricity, and even water, are sold at higher rates for domestic use than for industrial use. Milk is sold at different prices according to its use; whether as fluid milk, or for the production of butter, cheese, condensed milk, or some other end product. Certain products such as lime are sold at a lower price for use in the chemical industry than in the fertilizer industry. Lower prices are charged for "original equipment" tires, spark plugs and batteries than for the same products for replacement.

The re-transfer of supplies from the low-priced sub-market to the higher-priced one not infrequently presents serious problems for the discriminating seller in the case of products but rarely in the case of services.

2. Discrimination between localities: In general, differences in prices at different locations will constitute discrimination if they do not reflect differences in transportation costs, although such price differences may also be based on other factors. There is a variety of ways of charging transport costs. One method would be for the buyer to defray the actual cost of delivery, and this would not involve spatial discrimination. Others, that are considered to be discriminatory, would include freight equalization systems, uniform delivered price systems, zoning systems, and systems according to which transport costs are calculated from certain "basing" points, which may not always be the point of shipment. "Dumping" in international trade would also fall within this classification.

3. Discrimination on a time basis: Here, also, the criterion is whether the prices charged reflect variations in cost. Telephone rates, some public utility rates, transportation rates, as well as many others, may vary with the hour of the day, the week, the season, special holidays, and so on. In attempting to evaluate such differences on the score of discrimination complex questions are raised as to the way in which costs should be calculated to show fluctuations over time.[1]

4. "Personal" discrimination: Although this category was originally based on the practice of physicians, surgeons and lawyers of discriminating among their customers on the basis of their capacity to pay, today it more frequently relates to that type of discrimination among firms which is determined on an individual basis. Most frequently, an attempt is made to keep such discrimination secret. The rebates given by the United States railways to the Standard Oil Company in the 1870's are frequently given as an example. Buyers who are in a position to produce certain goods for themselves are able at times to obtain preferred buying terms. Buyers who make large-volume purchases are often able to obtain preferential treatment on prices or other terms of the sales contract by threatening to change suppliers. The seller may classify buyers into different buying categories on a rather arbitrary basis, such as was disclosed by the Loss-Leader inquiry to be the case in the Canadian cigarette industry. The special terms for the purchase of cans and the use of closing machines accorded to Canadian Canners Limited by the American Can Company in 1930 for a twenty-year period reported by the Royal Commission on Price Spreads, would fall into the same general category of discrimination.

Secret arrangements of the sort here referred to remain secret at best only so long as it suits the purpose of the beneficiary of the preferential treatment. Such concessions can frequently be used to bargain for greater concessions from other sellers, although the beneficiary may gain a competitive advantage over his rivals by keeping the concession secret which would be lost if it became known to other suppliers that such special terms were being offered. Even where disclosure of the extent or nature of the special concession is not made explicitly, "low" re-sale prices by the beneficiary of the discriminatory price may arouse suspicion of the existence of the concession, with resulting pressure from rivals of the beneficiary for better terms from all suppliers.

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1. See, e.g., A.R. Oxenfeldt, Industrial Pricing and Market Practices, pp. 240-1.

In fact, the possibilities are numerous and difficult to foresee. It is even suggested by some writers that no secret price discrimination remains secret for long. There are, however, enough authenticated cases of secret concessions persisting for long periods of time to make this generalization suspect, and it may be doubted that they all fall in the category of the traditional exception.[1]

## Other Classifications

Another classification of types of discrimination is based on the different principles of behaviour that may be adopted by firms. The principles suggested are: (1) the "independent maximization" principle, the type in which the individual seller attempts independently to maximize his profit; (2) the "collusion" principle, by which a common course of action with regard to prices is adopted, as in some basing-point systems; and (3) the "predatory competition" principle, by which, for example, local price cutting by large firms is used to eliminate smaller competitors or to force them to come to terms.[2] Although, from the public policy point of view, this classification would seem to have much to recommend it, it rather states the problem than provides answers. For example, a reduction in the price of a product in the present may result in increased output in the future, but whether it is due to (1) new consumers being induced to try the product by the low price and then continuing to purchase it even after prices are raised; (2) the elimination of competitors by predatory price cutting; (3) the achievement of economies of larger-scale operation making possible a long-run reduction in price, or to some other factor, is of basic importance for policy. The problem of disentangling motives and effects inevitably presents serious difficulties.

Still another classification[3] of types of price discrimination would distinguish <u>systematic</u> price discrimination which involves price differentials as an inherent part of the price

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1. See Oxenfeldt, pp. 247-8 for further discussion of this point.

2. See A.G. Papandreou in <u>Business Concentration and Price Policy,</u> p. 438.

3. See J.P. Miller, <u>Unfair Competition,</u> pages 125-6.

structure from unsystematic price discrimination which often develops in the process of adjusting prices from one level to another. A distinction is also sometimes made between temporary and persisting types of discrimination. Local price-cutting having the purpose of eliminating a competitor would be an example of temporary price discrimination. Finally, purposive discrimination is distinguished from incidental discrimination. The former refers to discrimination adopted for the purpose of maximizing revenues by segregating buyers with different elasticities of demand into separate sub-markets. An example would be the pricing policy pursued by the milk industry in which prices differ depending upon whether milk is to be used for fluid purposes, the making of cheese, butter, and the like. Incidental discrimination is considered to occur when, for example, buyers are divided into quantity categories and one buyer lies just above the minimum value of a category and another buyer lies just below that minimum.

This review of some of the classifications of types of price discrimination[1] emphasizes the ubiquity of the practice. It is also pertinent to suggest that in view of the variety of settings in which, and the purposes for which, price discrimination is employed, analysis is likely to be most fruitful if carried out on a case by case basis.

## Some Economic Aspects of Price Discrimination

It may be worthwhile at this point to examine, on the basis of generally accepted principles of economic analysis, some of the major aspects of economic performance that are affected by price discrimination. The analysis applies first to those types of discrimination in which the individual seller attempts independently to maximize his returns.

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1. There are numerous other classifications of which the more interesting are: Fritz Machlup, "Characteristics and Types of Price Discrimination", in Business Concentration and Price Policy; and Ralph Cassady, Jr., "Techniques and Purposes of Price Discrimination", Journal of Marketing, Oct., 1946, Vol. XI, No. 2.

Allocation of Resources. One of the major considerations involved in assessing the over-all performance of the economy relates to the allocation of resources among uses; and it is this aspect of economic performance that is frequently brought into question, implicitly or, less frequently, explicitly, in discussions of individual instances of price discrimination. The basic issue concerns the relative quantities in which various goods are produced and what constitutes the best ratio from the standpoint of buyer satisfaction. The general conclusions of economic analysis on this matter are well summarized in the following comments by Professor Joe S. Bain [1]:

> "Enterprises in any line of production, seeking profit, tend to extend their production whenever the marginal costs of production (as determined by money factor prices and the relation of cost to output) are short of their marginal receipts as ultimately derived from the demands for their goods. When all enterprises in an economy pursue such a course simultaneously, readjusting as various separate demands for goods shift, outputs and prices for all goods are mutually determined such that in the final balance or general equilibrium: (1) the prices of all goods stand very roughly in the same relation to their average and marginal costs of production, but potentially in various different specific relations, depending on market structures, and (2) the relative outputs of goods are those which buyers are willing to take given the pattern of relative prices thus established.
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> . . .
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> We have previously shown . . . that if all of the given range of goods were produced under conditions of pure competition, the composition of aggregate output would be such that every price would tend toward equality with the money value of marginal real cost, and that allocation would

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1. Price Theory (New York, 1952), pp. 444-45.

> then be demonstrably ideal. We have also indicated that if certain goods were monopolized, so that output was so restricted that marginal cost was short of price, whereas others were produced so that marginal cost equaled price, allocation would not be ideal, since a balanced ratio between price and marginal cost would not result and could be effected only by shifting resources toward the production of the monopolized goods and away from the other lines. Non-ideal allocation results when relative outputs are such that the ratio of price to marginal cost is different for different industries.
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> With those general guides, what can be said of allocation at a given level of employment in the economy we have? In this economy certain markets are purely competitive, with prices tending to equal marginal cost; some are in monopolistic competition, with presumably slight price-marginal-cost discrepancies; a few are single-firm monopolies with larger discrepancies of this sort, except where public regulation intervenes; many are oligopolistic, and in these relations of price to marginal cost are various and not definitely predictable. Monopsonistic elements introduce further discrepancies, as does discriminatory pricing of the third degree."

It is on the basis of this analysis that price discrimination, on the ground that it can be practised only in situations characterized by some degree of monopoly power, is said to fail to meet the price-marginal cost test (even though it may meet the marginal revenue-marginal cost test), and thus to distort the allocation of resources. On the other hand, if the industry structure is already such that significant price-marginal-cost discrepancies exist, it is not impossible that price discrimination could reduce rather than further increase the distortion in resource allocation. However, the possibilities here are so varied that useful general analysis is difficult.

Apart from the features it possesses in common with other monopolistic situations, price discrimination has a distinctive feature in that the relationship of price to marginal cost will vary <u>for the same product</u> among the sub-markets in which the product is sold at different prices. Considering aggregate welfare, the sub-market with an elastic demand will be charged lower prices and "too large" a share of resources will be devoted to supplying it, whilst the sub-market having an inelastic demand will be charged higher prices and "too small" a share of

resources will be devoted to supplying it.[1]

Price discrimination that distorts the allocation of resources would not necessarily fall within the category of anti-competitive behaviour that would be illegal. Discrimination must be between "competitors" to be illegal. In terms of the example used by A.R. Burns[2], sales of lime at one price to fertilizer manufacturers (and farmers) and at another to chemical manufacturers would be untouched so long as there was no illegal discrimination among fertilizer manufacturers and chemical manufacturers. Burns continues:

> "Such discriminations do not occur in a competitive market. Sellers sell at the highest price offered and are as indifferent to the use to which the product is to be put as they are to the girth measurement of buyers. Furthermore, in so far as the broad principle of competition has been approved because of its effect upon the utilization of resources, serious departures from this utilization occur when the seller finds it possible and profitable to restrict the activities of farmers while encouraging those of chemical manufacturers."

There are two other aspects of the performance of the economy on which price discrimination is also sometimes claimed to have a significant impact; productive efficiency and income distribution.

Productive Efficiency. The aspects of productive efficiency that are frequently considered to be relevant to price discrimination concern the measure in which the scale of operations of the business firm conforms to the most efficient scale, and the degree to which capacity is fully utilized.

On this latter point, Professor J.M. Clark argues that one of the most important economic consequences of overhead cost can be summed up in the expression, "Discrimination is the secret of efficiency". He continues,

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1. See Bain, Price Theory, pp. 413-14

2. In Werne, Business and the Robinson-Patman Law (1938), p. 15.

> "This last, to be sure, needs to be taken with a proviso: one must know where to stop. The economic basis of it is simple. Existing business may or may not cover all overhead costs, but in either case, if there is spare capacity, added business will cause no added overhead, and will be a gain at anything above differential cost, so long as it can be kept separate from existing business, so that existing earnings are not impaired. This leads to a system of making each separate section of the business pay the largest possible yield above differential cost. A 'section of the business' may mean a single customer or a single sale, but, in general, classification is limited by the extent to which business convenience makes it practicable, or public sentiment makes it prudent.
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> For discrimination is not solely an economic fact. It raises moral and social issues: it is the tool of favoritism and greed and the vehicle of the highest social justice. It may rouse our righteous resentment or our admiring commendation.[1]"

Discriminatory pricing to achieve profitable employment of "spare capacity" is, as has been suggested, only one aspect of productive efficiency. The longer-run problem relates to the question whether a producer by adopting a system of discriminatory prices can expand his output and thereby achieve - not more efficient use of existing plant, although that, as Clark points out, can often be attained - but a different combination of the factors of production which will make possible lower average and marginal costs. In other words, the question is whether costs will be reduced even compared with costs under optimum-capacity production in the plant-size employed before discriminatory pricing was adopted. The outcome in this type of case is likely to be less certain than in the "utilization of excess capacity" case.

The argument cannot here be explored in detail but some of the issues involved may be briefly referred to. It is true that profits will be greater after the adoption of discriminatory prices than under a single-price policy; that, of course, is the purpose of adopting discrimination. Hence, there will be an incentive for the discriminating seller to increase output. In general, it is considered likely that investment and output will

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1. Studies in the Economics of Overhead Costs (Chicago, 1923), p. 416.

increase under discrimination.[1] But whether this increased output will be produced at lower cost to all buyers than the output under the single-price policy is less certain. This will depend, in part, on whether economies of scale are possible from the technological and organizational points of view. Not all industries offer the same opportunities for adopting more efficient, larger-scale methods of production. Moreover, where sellers are few there is no assurance that optimal efficiency in scale will result from the pressure of market forces. Bain has remarked:

> "Either an excessively large or an excessively small number of firms (from the standpoint of efficiency in scale) is possible with oligopoly, as is a size distribution of firms which is other than the most efficient. Without detailed empirical investigation we are thus in a state of considerable uncertainty about the probable efficiency in scale of a large sector of the actual productive organization."[2]

Miller, in dealing with this question, concluded that if the increased profits resulting from price discrimination attract new firms to the industry, the result may be that each firm will be operating at less than its optimum output. He adds:

> "Thus, while it may be true that discrimination by one firm may enable that firm to achieve the economies of large scale and to attain a more efficient utilization of plant all other things remaining the same, it does not follow that discrimination practised by all under conditions of monopolistic competition will enable the industry as a whole to do so. Under these circumstances it is not conceivable that prices would be lower to all buyers as a result of the discrimination."[3]

If, however, entry is difficult for new firms, because, for example, price discrimination permits a seller to enter an opening too small to support the establishment of a new firm,[4] or if

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1. See Joan Robinson, Economics of Imperfect Competition, Chapters 15 and 16, esp., p. 201.
2. Price Theory, p. 447
3. J.P. Miller, Unfair Competition, p. 165
4. See Morris A. Copeland, "Competing Products and Monopolistic Competition", Quarterly Journal of Economics, Vol. LV, Nov., 1940, pp. 26-28.

co-ordination among the oligopolists is breached by a "big buyer" who offers opportunities for expansion to optimum scale to one or a few producers, or if for some other reason Miller's assumption is not realized, discrimination may become a factor of major significance in bringing about a more economical scale of operations.

The view is also expressed, often rather obliquely, that price discrimination has assisted in the development of innovations, particularly more economical distributive arrangements. These new techniques of distribution, it is claimed, required the assistance of reduced buying prices to force an entry into the established system of distribution and once they were operating in a substantial way so that they realized the economies of scale associated with their new methods, they brought about an over-all reduction in distribution costs, part of which, at least, was passed on to consumers in the form of lower prices. Once effectively established, the new techniques would presumably be able to rely on their own superior efficiency rather than on lower buying prices, although the claim to preferred treatment might then be advanced on other grounds, such as quantity purchases, more effective promotional services, and the like. It is said to be difficult to follow this argument very far: first, because potential innovations are likely to be numerous and there is no certain method of identifying the successful one(s) in advance; or, to put it differently, innovations should prove their claims by their performance in the market place without prejudging by suppliers. And, second, because the available evidence, particularly on the distribution of grocery products to which the argument is frequently said to apply, is at the least of an equivocal nature. A number of observers have, for example, pointed out that the major recent innovation in distribution in the food field, the super-market, was made, not by chain stores which were the recipients of preferred treatment by suppliers, but by independent merchants who made their inroads, in the early stages at least, by substantial reductions in operating expenses. In opposition to these views it is maintained that if it were required that specific cost savings be demonstrated in advance by new methods of distribution, the result would be to impose a serious limitation upon the flexibility of the distributive system.

Income Distribution. The aspect of income distribution to which price discrimination is most frequently considered to be relevant is that of profits received by enterprise. Here, as in the preceding sections, the structure of the market is considered to be of basic importance in determining the outcome. In market structures characterized by large numbers of firms and easy entry,

whether the conditions are those of pure or monopolistic competition, there is a tendency for all excess profits to be eliminated under the pressure of impersonal market influences. Where there are few firms, as in monopolistic, oligopsonistic or monopsonistic market structures, excess profits tend to emerge and to be maintained in so far as barriers to entry exist and depending upon the magnitude of such barriers. Price discrimination raises the level of such profits in some cases. Although excess profits give rise to a greater inequality in personal income distribution than would otherwise occur, it is also maintained by some writers that they provide an incentive to greater efficiency, to a higher level of investment and to a more vigorous pursuit of new techniques.

Summary. This very general review of the major aspects of the performance of the economy that are likely to be affected by price discrimination on the "independent maximization" principle emphasizes the extent to which the significance of any individual case of price discrimination must depend upon its particular circumstances; however, it may be useful to summarize very briefly a few of the leading points that emerged:

(1) Where the industry structure is characterized by a "large" number of firms and entry is easy, impersonal market forces will impose tendencies towards optimal allocation of resources, utilization of capacity and economies of scale, and also the elimination of excess profits. Price discrimination in such circumstances is neither desirable nor is it probable. Such industry structures are, however, not common.

(2) Where the industry structure is characterized by a "few" firms and there are difficulties of entry, some degree of co-ordination in pricing and other aspects of policy can be expected and the individual firms do not take their demand-and-supply functions as given. In such conditions price discrimination is possible and its consequences may be desirable or undesirable. Depending upon the circumstances of the individual case, price discrimination may improve or worsen the allocation of resources; it may be used to achieve full-capacity operation; it may make possible economies of scale or it may impair the attainment of such economies; and it may enhance excess profits with undesirable effects on income distribution but possibly with favourable effects on economic progress.

Some Further Aspects of Price Discrimination

Price discrimination is not restricted to those forms in which the individual firm attempts independently to maximize its returns. As has already been pointed out, price discrimination may form an important element in certain common courses of action which have the purpose or effect of restricting competition. Basing-point systems and some other types of delivered pricing systems, such as zone pricing, are considered to belong in this category. There is an extensive literature on this subject. No attempt will be made in the present survey to summarize it, in part because of its magnitude but chiefly because the issues raised where such collusive pricing systems are in force relate more directly to the general question of agreement on prices than to price discrimination as such. It should perhaps be added that although some observers are inclined to consider the existence of zone delivered price systems and other similar arrangements to be prima facie evidence of collusion, it is also argued that price discrimination, which involves a widening of the area to which a blanket price applies or "otherwise meeting competitors' prices in remote places", may be adopted independently by a seller with a view to increasing the scale of production. Realistically, each case should be analysed on the facts peculiar to it and on the surrounding economic circumstances, although it seems probable that a fairly clear general distinction could be made between what has been called "co-operative formula pricing" and unsystematic area pricing on the basis of individual efforts to expand sales. Where the latter is the case, the considerations reviewed in the preceding section ("Some Economic Aspects of Price Discrimination") would be relevant.

Price discrimination can also be employed as an aggressive weapon in certain forms of "predatory competition". A large firm selling in a number of areas may engage in local price cutting in order to eliminate a smaller competitor selling only in one area, or, if not to eliminate him, to force him to come to terms and accept the "leadership" of the larger seller. In its early, cruder forms, this type of behaviour was one of the major factors in the United States in rousing public sentiment against "the trusts". The examples of local price cutting that are met with currently are less clearly classifiable than the early types. For example, a small firm wishing to increase its sales may reduce prices in a limited market area; its larger rival may not only match the price reduction but cut below it in the limited market area of the smaller seller without changing the price in the remainder of the market.

Small sellers often explain their reduction by the argument that in order to gain a place in the market against large, established firms selling a differentiated product, they must resort to price concessions. Their larger rivals reply that they have every "right" to prevent this filching of their customers. In a competitive economy, this appears tantamount to saying that an established market position is not subject to erosion except on the terms approved by its holder.

It is argued by some authorities[1] that there are "definite limits" to the extent to which the discriminatory price-cutting will be carried. It is considered to be unlikely that the price in the "local" area will remain for long much below "the price determined by the natural scarcity of the whole", since heavy price-cuts in one section of the market will spread, more or less speedily, to other sections of the market, thus affecting adversely the interests of the larger seller. The larger seller is likely, therefore, to show restraint in the extent of his retaliatory price-cuts. Furthermore, the larger seller will not need "to act aggressively because of the very strength of the tacit threat in his possession", which enables him to inflict much greater relative sacrifices upon his smaller competitor than he will experience, himself. Hence, the tacit collusion inherent in the situation, based upon "the continuous impending threat to price-cutters", is likely to be maintained.

Whether or not this reasoning is considered to be persuasive in a general sense, it is obviously no substitute for an examination of the facts of the individual case, including the history of the firms, economies of scale in the industry, cost-price relationships, and the like, which would be of determining importance in assessing the impact of the discriminatory price policy. If, on balance, the major determinant of the discriminatory policy appeared to be that of consolidating a position of market power, there would be strong reason for striking it down and establishing conditions which would permit greater scope for independent behaviour.

## The Big Buyer

There are numerous other situations in which price discrimination appears as a strategic factor; however, one of

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1. E.g., W.H. Hutt, "The Nature of Aggressive Selling", *Economica*, Vol. II (New Series), Aug. 1935, pp. 313-14.

these has been the subject of particular attention in recent years - indeed in the minds of many people it is the problem of price discrimination - and some rather detailed reference to it should be made at this point. The situation in question is that in which a big buyer obtains preferred buying terms, whether in price or service, or both, over those available to his smaller competitors.

The basis upon which the analysis of this situation usually proceeds is that provided by J.M. Clark.[1] Clark argued that where competition was imperfect - because of fewness of sellers, identical and sticky price quotations resulting from "oligopolistic" behaviour, and the like - an attempt to introduce other conditions characteristic of "perfect" competition might well lead to greater rather than less imperfection, and that to obtain a "workably satisfactory result" in such circumstances it would be necessary to achieve some degree of "imperfection" in other conditions in the market. For example, where a few producers were pursuing a tightly co-ordinated (but not collusive) policy on pricing, the most effective method of bringing about a better economic performance might be through the introduction of temporarily secret and discriminatory price-cutting which could very well result from the pressure of one, or a few, large buyers. The purpose of laws against "unfair discrimination" in such circumstances would presumably be "to adjust the prices . . . to what they might be assumed to be if there were price competition between sellers",[2] with a view to promoting economic efficiency but to limiting the impact of financial strength and coercive bargaining. Needless to say, the line is not easily drawn.

The detailed list of factors providing the economic justification of the big buyer have been well summarized by Dirlam and Kahn as follows:[3]

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1. "Toward a Concept of Workable Competition", Readings in the Social Control of Industry (1942), esp. pp. 454 ff.

2. A.R. Burns in Law and Contemporary Problems, Vol. IV, No. 3, June, 1937, p. 308.

3. Joel B. Dirlam and Alfred E. Kahn, "Antitrust Law and the Big Buyer: Another Look at the A & P Case", The Journal of Political Economy, April, 1952, pp. 120-1.

"A. The big buyer has the following advantages over a host of small buyers:

1. Superior coverage of the market, i.e., superior knowledge of market conditions and hence ability to buy more prudently.

2. The capacity to take on new manufacturing and distributive functions (e.g., brokerage and advertising for suppliers) in addition to retailing proper and, if not to perform them more efficiently, at least to offer competition in this way to established agencies of distribution.

3. The power to exact price concessions by threat of withdrawal of patronage.

B. In the exercise of these capacities the big buyer contributes to more workable competition in two ways:

1. It beats down suppliers' prices,

a) By getting 'inside the market' in a nondiscriminatory fashion, i.e., taking advantage of its broader coverage of the market to find bargains, and

b) By exacting discriminatory concessions, under whatever guise. Suppliers in an imperfect market, reluctant to reduce prices openly, may be persuaded to extend secret discriminatory discounts to get large orders.

c) The lower prices obtained under both (a) and (b) above have a tendency to spread. These savings enable the large firm to put pressure on its competitors, who return to their suppliers and demand better terms. Thus in the end the spread is narrowed between high- and low-price suppliers, and all are drawn into price competition.

2. It improves resource utilization in the entire industry:

a) By cracking rigid suppliers' prices and introducing intensified competition at all levels

of the distributive process, it helps weed out the unfit and forces additional attention to cost reduction.

b) By exacting price concessions, it shifts the emphasis of supplier competition from advertising to price.

c) By performing distributive functions more efficiently: its own buying offices supplant brokers, and its own advertising expenditures serve the double duty of promotion for itself and its suppliers.

d) By making possible a fuller utilization of suppliers' plants."

Whether there is a need for the possibly salutary influences of the big buyer must, of course, depend upon conditions in the markets where his purchasing is carried on. The conditions that are commonly considered to justify the need for the types of pressure the big buyer may be able to exert are:[1]

(1) Where suppliers are few and powerful and, in the absence of big buyers, would pursue tightly co-ordinated policies and perhaps earn substantial monopoly profits[2]

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1. Generally following Dirlam and Kahn in The Journal of Political Economy, April, 1952, and in "Price Discrimination in Law and Economics", The American Journal of Economics and Sociology, April, 1952.

2. Because profits are, and have been, low, it does not necessarily follow, as Dirlam and Kahn maintain, that the oligopolists have not "exploited the consumer by their soft competition". For example, Sir David Maxwell-Fyfe has remarked, "The predominance of the motive of security and stability in British monopoly accounts for the rarity with which its critics have been able to prove that exorbitant prices have been charged or greatly excessive profits made. Even the trust as well as the parties to a price agreeement prefers a quiet and a long life to a course which may bring the threat of new competition and will certainly attract public notice." Monopoly (1948), p. 23.

(2) Where imperfections of competition among suppliers may show themselves in excess capacity (not attributable to variability of operations due to seasonal and other factors) or other inefficiencies.

(3) Where there is evidence of suppliers' excessively high distribution expenditures, such as heavy advertising and selling expenditures.

Even where these conditions, or some of them, are found to exist, there must, as implied above, be certain further conditions prevailing before the discriminatory treatment can be considered as being likely to promote the public interest. First, the preferred terms granted to the big buyer "must be translated into price reductions, which benefit the consumer directly, and transmit the pressure through the big buyer's competitors back to suppliers, thus causing the concessions to spread." There would obviously be little gain in merely transferring monopoly profits from supplier to buyer, or in cutting down suppliers' excessive distribution expenditures whilst encouraging such expenditures by buyers. Second, "the big buyer must not be so powerful that it can exploit its suppliers". As J.M. Clark has pointed out, there is no advantage to be gained from driving prices below an efficient producer's cost of production, although, of course, sufficient pressure both from other producers and from buyers to keep costs at a minimum is of basic importance.

## Functional Pricing and Other Matters

A common complaint about price discrimination relates to trade (functional) discounts or the "unfair" classification of purchasers. It is a long-standing marketing practice for producers to sell identical products at different prices according to whether the purchaser is a jobber, wholesaler, retailer, or final consumer. The differences in the extent to which different classes of distributor take over from the supplier such functions as storage, transportation, selling, breaking bulk, and the like, would presumably be reflected, more or less accurately, by differences in the discount granted. Such pricing practices may be discriminatory, it is claimed, if the differences in the price to the different classes of distributor do not relate closely to the differences in the cost of doing business with each class.

However, it is less the magnitude of the difference between the prices to the different classes of buyer that is complained about in representations made to the Director than the refusal of a supplier to grant, say, the wholesale discount to buyers who claim to be performing (or to be prepared to perform) the wholesale function. That is, such complainants less frequently maintain that the wholesale discount is too large than that they are denied it. The Green Book on Loss-Leader Selling reported (at pp. 220-222, 262-266) examples of unsuccessful attempts by groups of retailers, some at least with central warehouses, to obtain recognition as wholesale buyers of cigarettes. In the same study (at pp. 233-248), there is an analysis of the comparative volume of cigarettes purchased by different categories of buyers (jobbers, direct retailers, and "regular" retailers) in the city of Vancouver. The jobbers paid the lowest price, the direct retailers the next higher level, and the "regular" retailers the highest price. It was established that numerous "regular" retailers purchased larger quantities of cigarettes during the period under review than many direct retail and even jobber accounts, and that a number of direct retailers also purchased larger quantities of cigarettes than many jobbers. That is, purchasers of greater quantities were often charged higher prices than other buyers. The functional discount, as such, takes no account of the quantity purchased.

Where each stage in the process of distribution is separate and distinct from that below it and that above it, there is likely to be little complaint from the different categories of distributor. Wholesalers will not in such circumstances compete with retailers. The difficulties grow out of the fact that in recent years there are no closed categories of wholesalers and retailers. Functions tend to become blurred. Retailers may operate as local, regional or national chains, or as mail-order houses or department stores and they may perform wholesale as well as retail functions. It is when such "retailers" are accepted as qualifying for a functional discount at a stage closer to the supplier and compete with unintegrated sellers - who do not qualify for the larger discount - at some later stage of distribution, that charges of "unfair competition" are likely to be heard. For example, the Manitoba Division of the Retail Merchants' Association of Canada Inc., in correspondence with the Director, has taken the position that the granting of a jobber's discount by the manufacturers of cigarettes to chain stores and certain other buyers which did not depend upon the quantities purchased, was prejudicial to the competitive position of the independent unintegrated retailer. The claim has been made to the Director by more than one disadvantaged seller that his

inferior competitive performance was due, not to any lower degree of efficiency than that of his rivals in performing the distributive functions he undertook, but solely to the discount category in which he was placed by his suppliers.

There should obviously be a minimum of interference with increased integration in distribution, and the accompanying ability to qualify for more comprehensive functional discounts, where it is based on genuine economies of scale. The same case does not hold where the better discount category is restricted to a few who hold it because of a superior strategic position. Problems relating to the institutional difficulties associated with the availability of capital to small enterprises wishing to pursue a policy of vertical integration clearly require consideration[1] along with some of the factors which have been referred to under the heading, "The Big Buyer".

Finally, such specific matters have been raised with respect to price discrimination as whether prices to large buyers for merchandise to be sold under their private brands are "unfairly low" as compared with prices for the same product sold under the producer's brand; whether volume discounts irrespective of the quantities delivered to the separate plants or units of a purchaser are discriminatory; whether cumulative discounts, i.e., discounts based not on the size of individual orders but on total purchases over a specified period of time, constitute discrimination; whether a seller's refusal to give discounts to quantity buyers where there are demonstrable savings in cost constitutes discrimination, and so on.

The general approach of economic analysis to matters of this type has been outlined above in the section, "Some Economic Aspects of Price Discrimination", and only a few limited comments of a more specific nature will be added here. With reference to quantity orders, it is argued that if they are current orders, a number of small orders can raise the rate of operation as effectively as a large one equal in amount to the sum of the small ones.

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1. The view has been advanced from a number of sources that a major factor accounting for the relatively large number of firms each controlling a few supermarkets in the United States, as compared with the very high degree of concentration of control in this field in Canada, is the difference in the nature of banking facilities. Local banks in the United States are said to have provided capital for such local enterprises, whilst this source has not been available in Canada.

Manufacturing costs are likely to be the same in the one case as in the other. Indeed, if a large order is received when the plant is near capacity, manufacturing costs may be increased. The cost of obtaining and distributing a number of small orders, however, is likely to be higher than that of obtaining and shipping a single large order, hence, some saving on these elements of cost should be possible.

Large orders for future delivery may open up several possible sources of savings. Orders for the slack season or for "off-peak" periods may make it possible to achieve an average rate of operation which will make possible cost reductions compared with the situation where the plant is operated irregularly. Such orders may also make advantageous raw material purchases possible. Where advance payments on account of orders are made, they may assist in supplying needed working capital. The large buyer may assist with ideas and designs that increase saleability. Some large orders may not involve the usual guarantees to jobbers and other customers to protect against price declines, or to return unsold goods.

It is argued with reference to cumulative discounts that they do not assure economies of production or distribution since if the large buyer purchases on a hand-to-mouth basis his demands may be as spasmodic as those of small buyers and may occur at the same time. It is also maintained that such discounts tend to tie customers to a seller when it is not in their interest to be so tied, and when it would promote competition to have each buyer search out the best terms available on his purchases.

With reference to the possibility of discrimination against large buyers arising from the refusal of sellers to grant demonstrable savings in cost on their purchases, it is sometimes simply denied that this situation can arise since the great bargaining power of large firms will be sufficient to prevent any impairment of the legitimate economic advantage to which their mass purchasing may entitle them. "Bargaining power", on the other hand, is a relative matter and powerful sellers may, in some circumstances, prove the equal of large buyers, and they might, on considerations that seemed to them adequate, discriminate against these large buyers. One consideration could very well be that they feared the emergence of a few large distributors who would over-power them. Although discrimination of this sort would have to be condemned on the basis of the economic considerations already discussed, it is doubtful if such issues can be evaluated solely in

terms of economic criteria.

## Refusal to Sell

In recent years complaints received by the Director indicate that refusal to sell has become a matter of concern in a number of different fields. Dr. Vernon A. Mund has defined the term "refusal to sell" as follows:

> "[It] generally means action by a commercial seller, holding himself out as selling to the public, in refusing to sell units of the same class of goods to some buyer or buyers, offering to meet the terms of sale, at the same time that sales are being made in the same market to other buyers. Refusal to sell typically means a refusal to sell to some buyers in the same market. It is a practice of selecting customers - of discriminating among them - by selling to some and at the same time not selling to others. As a result, commodities do not move to the highest bidders on an impersonal basis."[1]

In Canada where the number of possible suppliers in many fields is very limited the relative freedom with which suppliers accept new customers may be a matter of considerable significance in maintaining competitive conditions.

In a competitive environment sellers would be free to choose their own customers but they would choose only on the basis of the price offered. The power to withhold goods stems from some degree of monopoly power which may derive from control of a well known brand name, control of the raw materials used in production of a commodity, and the like. Patent rights and tariff restrictions may assist in retaining control of supply.

Refusal to supply may be employed in a variety of circumstances and with a variety of consequences. For example, a supplier may restrict his outlets, perhaps on an exclusive agency

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1. Report prepared by Dr. Mund for the Select Committee on Small Business, United States Senate, The Right to Buy - and its Denial to Small Business (1957), p. 11.

basis, because he wishes his product to be sold only through a certain type of outlet, such as drug stores, where a characteristic mark-up tends to be taken. By eliminating distributors taking lower margins, the supplier may effectively restrict price competition. A vicious circle may also develop in which an association of manufacturers refuses supplies to certain firms because they are not members of an association of wholesalers. The wholesalers' association may, in turn, refuse to recognize the firms because they do not have "sufficient volume" to be classed as wholesalers. Or, a manufacturer may threaten his distributors that their supplies will be cut off in order to prevent them from handling the products of a new manufacturer.

The practice of selling only to certain distributors, adopted by one or more manufacturers having substantial control of the total output of a product, can have serious detrimental consequences. Rigidities may develop and spread throughout the industry; the incentive to achieve greater efficiency or to promote technological innovation may be weakened since new firms cannot, through greater efficiency or technological advance, gain status as distributors.

Again, a monopolist, who has control of certain basic raw materials and whose operations are vertically integrated, may decide to refuse supplies of raw materials or partially processed products to potential manufacturers; otherwise he would be permitting the introduction of new competition.

Refusal to sell, although clearly representing a form of discrimination, differs in important respects from price discrimination. This latter has to do with different prices to buyers in different sub-markets, with buyers being free to buy without further restriction. Some forms of price discrimination, as in the granting of functional discounts, may have consequences similar to those resulting in certain circumstances from withholding supplies; but refusal to sell is by its nature and its consequences of much broader scope in that it involves the more or less complete denial of access to market supplies. Price discrimination, as has been argued above, may under certain conditions contribute to improving the workability of competition, achieving economies of scale, and the like. Refusal to sell, on the other hand, is a direct limitation of competition. Whether such limitation is likely to be contrary to the public interest will, of course, depend upon the surrounding business circumstances, such as peculiar features of the product and of the system of distribution employed, alternatives available to buyers, and so on.

## The "Cost Principle" in Price Discrimination

In the preceding discussion it has been pointed out that the primary test of economic price discrimination is based on the relationship between the return received for the product-service in question and the "cost" of providing it. Price differentials which do not accord with cost differentials are regarded as discriminatory. One of the economic consequences of such discrimination, as was also stated above, is that it gives rise to a maldistribution of resources as between different uses.

"Cost" is not an unambiguous concept. As used by economists in the analysis of price discrimination, it frequently refers to "marginal" cost, that is, roughly, the added cost of an additional unit of output. Used in this way, so long as the added revenue covers the added cost, there would be no price discrimination.[1] Used in this way, for "correct" pricing, the seller would not need to allocate fixed costs to particular items or portions of output.[2] Short-run marginal costs are the relevant magnitude for assuring optimum utilization of existing facilities and, according to familiar analysis, if price and production policies were based on average rather than marginal costs, output and employment would be restricted. Marginal cost pricing is not, as has been noted, the test for determining whether or not there is

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1. The Advisory Committee on Cost Justification in its Report to the Federal Trade Commission (February, 1956) dealt with various aspects of the cost proviso in Section 2(a) of the Robinson-Patman Act. This proviso permits a seller charged with illegal price discrimination to defend such a charge on the ground that his differentials in price "make only due allowance for differences in the cost of manufacture, sale, or delivery resulting from the differing methods or quantities in which such commodities are to such purchasers sold or delivered." Only one point in the Committee's analysis needs to be noted here, and that is its refusal to adopt the marginal cost approach to cost justification. The chairman of the Committee pointed out in The Antitrust Bulletin, January, 1956, that "the legislative history of the Act and its obvious intent are completely opposed to" the marginal cost approach.

2. In practice, the distinction between fixed and variable costs will not always be easy to make. See Alfred Marshall, Principles of Economics (8th ed.), pp. 360-1.

discrimination within the meaning of the anti-trust legislation, nor, it may be added, of the anti-combines legislation.

However, there are circumstances in which the customary interpretation of short-run marginal cost pricing would not provide the best outcome, either for production or employment. For example, if an increase in output which could be achieved by the adoption of discriminatory pricing were to initiate a decline in long-run average and marginal costs, it would be unrealistic to insist that the relevant marginal cost for price discrimination purposes must be that based on costs applying to immediate past experience (which is more or less what could be derived from accounting records) or even to current experience. Rather, in order to accelerate the movement to lower cost levels, the appropriate cost figure would be that of prospective marginal cost. Insofar as this is the case, it is clear that a policy requiring that price reductions be "justified" on a "provable" marginal cost basis would be static and retrospective in effect and could interfere with the achievement of economies of scale.[1]

It is sometimes argued against marginal cost pricing that it is rarely employed in industry. The argument proceeds on a number of different levels. First, there is the question of the availability of cost data. In multi-process, multi-product or multi-plant firms, it is claimed that the problem of allocating costs (particularly joint costs) is so complex that nothing approaching a reliable cost figure, either marginal or average, can be computed for individual products.[2] The difficulties are said to be even greater when it comes to distribution costs, not only because of the rudimentary state of distribution cost accounting but also because of the prohibitive cost involved in any attempt to determine distribution costs for an individual commodity.[3]

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1. It is important to recall that in marginal pricing under conditions of "imperfect" competition, the point of intersection of marginal revenue and marginal cost determines output and that the average revenue for this output gives the "appropriate" price. Hence the elasticity of demand of the individual buyer or group of buyers is of central significance in marginal pricing. Marginal cost does not uniquely determine price.

2. See, e.g., Fritz Machlup, <u>The Economics of Sellers' Competition</u>, (Baltimore, 1952), pp. 19 ff.

3. Malcolm P. McNair, "Marketing Functions and Costs and the Robinson-Patman Act", <u>Law and Contemporary Problems</u>, June, 1937, p. 339.

Corwin D. Edwards has pointed out with reference to the "cost justification cases" which have been argued before the Federal Trade Commission, that firms typically do not appear to compile cost data on a basis that makes possible the determination of differentials: "The cases in which respondents offered cost defenses have one striking common characteristic: Apparently, none of the respondents had devised methods of recording and analysing costs currently in such a way that management could determine price differences in the light of cost differences. Even the most careful of the cost defenses were based upon studies undertaken for the purpose of developing a defense in a pending lawsuit. In consequence of this procedure, respondents encountered many difficulties in obtaining adequate cost information and justifying the methods of allocation which they used." [1]

A criticism of cost justification as being capable of easy manipulation to give desired results is made by Walter Lichtenstein in the following comment on bank service charges in the United States:

> "A bank might not be permitted in the future to pay interest on demand deposits, but, as the matter stood, there was nothing to prevent it from seeking to attract a desirable customer by offering him all types of services free of charge, much as railroads were guilty at one time of offering so-called 'rebates' to certain favored customers. . . . To prevent, so far as possible, such evasion of the laws the various banking regulatory bodies made it mandatory for banks to charge 'out-of-pocket' costs for services rendered to all demand-deposit accounts. . . .
>
> All of this is quite proper but the hitch comes in determining exactly what constitutes 'out-of-pocket' expenses and costs. The intent of the law was not to make this requirement a means of greatly enhanced profit for banks but to safeguard them against ruinous competition. . . .
>
> To be sure, the offending banks can maintain plausibly, to their own satisfaction, if not to that of their customers,

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1. Corwin D. Edwards, "Cost Justification and the Federal Trade Commission", The Antitrust Bulletin, Vol. 1, No. 8 January, 1956, p. 569.

that their scale of service charges is justified. It would be a poor accountant who could not juggle the figures sufficiently for that purpose. Certainly, to anyone familiar with banking operations, it must be clear that in some areas, banks, by means of service charges, are not merely covering their 'out-of-pocket' expenses but are making a very handsome profit out of the recent development."[1]

Even if reliable cost data were available, or could be made available at reasonable cost, it is maintained by some economists that the marginal pricing technique is not, in any event, used by industrial firms. Some variant of an average cost approach is said to be the rule. This, again, is a topic on which there is a large body of literature of a specialist nature which it would not be profitable to attempt to review here. However, it may be of interest to quote briefly from a recent article dealing with this matter in the general context of price discrimination:

"The writer shares the dissatisfaction of Professor Gordon and others with the marginal cost function, but it is more than conceivable that its vulnerability centres more in the imputed precision than in its substance. A few observations are relevant without being conclusive. Generally, firms price many products closer to their concept of marginal cost than would be indicated by the marginal cost concepts that emerge from many economic treatises. Marginal cost is something more than its ascertainable and measurable elements. Risk and the additional cost of management, both of which are substantial, are marginal costs. Conceivably marginal cost must include a certain minimum amount which the business man considers necessary profit. When he says that the profit on a certain additional piece of business is 'not worth his time and trouble', he is giving expression to a very real concept of marginal cost. The writer also agrees with Professor Machlup's position that too rigid a definition of marginal cost would trap its users into unrealistic and untentable [sic] positions.

Cost accounting techniques indicating an average cost approach to price and product line policies have perhaps needlessly worried some defenders of marginal economics.

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1. Walter Lichtenstein, "Banking Service Charges", The Quarterly Journal of Economics, Vol. LXXI, No. 2, May, 1957, p. 318.

Typically, the determination of average costs (or standard costs plus a margin for overhead and profit) is a function of the cost accountant in the lower echelons of management. Cost analyses, however, represent only the basic data from which price and production strategy is plotted in light of other factors by top flight management. In different terms, average costs are significant to those in the management hierarchy who follow policy, but not necessarily to those who make it. To top management some circumstances might dictate pricing or the addition of a product at only a little above what the cost accountant's statement indicate [sic] to be marginal costs. Other circumstances might lead management to reject suggested additions to the product line that cover average costs several times over. To some extent the solution of the problem and the controversy involved turn on the period assumed for analysis. The longer the period for which strategy must be plotted, the greater becomes the percentage of total costs which must be characterised as marginal."[1]

In somewhat similar vein, Edward R. Hawkins, writing in The Journal of Marketing, concluded, after analysing a number of market price policies, that "The discrepancy between economic theory and actual pricing policies, as observed by marketing specialists is more apparent than real".[2] Price and output were, in fact, determined by the point of intersection of marginal revenue and marginal cost, although the seller might not, and need not, employ these concepts. At the same time, he emphasized the need to know "more about the pricing policies actually used by businessmen."

Two recent studies of pricing in the clothing industry, one relating to a firm of clothing manufacturers in Great Britain and the other to the garment industry in Western Canada[3], suggest that

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1. Eli W. Clemens, "Price Discrimination and the Multiple-Product Firm", The Review of Economic Studies, 1950-51, Vol. XIX (1), No. 48, pp. 8-9.

2. "Price Policies and Theory", The Journal of Marketing, Vol. XVIII, No. 3, January, 1954, p. 240.

3. Both studies appeared in The Journal of Industrial Economics: the former by N. Balkin, "Prices in the Clothing Industry", Vol. V, No. 1, November, 1956; the latter by William Lazer, "Price Determination in the Western Canadian Garment Industry", Vol. V, No. 2, March, 1957.

although prices are determined on what appears to be a rather wide variety of bases, considerations involving the marginal cost concept and the elasticity of demand of different buyers are not infrequently of determining significance. Mr. Balkin, the author of the first study, after setting out the basis upon which the "Costing Price" is established by his firm, then lists six different sets of circumstances in which a price lower than the "Costing Price" would be offered (or accepted). Some, at least, of these exceptions are determined on more or less precise marginal cost-marginal revenue considerations. Dr. Lazer states that "cost-plus pricing" is the method generally employed by Western Canadian garment firms in setting prices, although he considers that the cost figures used "are just rough estimates" and that the prices thus derived are often "bases for adjustments". He also lists nine other methods of determining prices "at particular periods of time or in determining the prices of specific garments. . . ." Among these is "direct-cost pricing" which approximates marginal-cost pricing, and others that involve the setting of prices with a view to the estimated elasticity of demand, as well as such other methods as "intuitive pricing", "monopsony pricing" and "prestige pricing". The garment manufacturing industry is considered by Lazer to be characterized by numerous firms and relatively easy entry, and as being highly competitive.

A wide variety of pricing methods is, however, not restricted to such circumstances if we may judge from the review of price policies by A.D.H. Kaplan in his 1954 study, Big Business in a Competitive Society. Dealing with the area of administered pricing - "the predetermination of a quoted price based on the firm's calculation of costs and prospects" - Kaplan attempted to classify price policies into such categories as price forcing (used when entering or expanding markets), price stabilization through market leadership, standard-cost pricing (said to be characteristic of the automobile industry), new product pricing, and de-emphasis of price (with emphasis on advertising, quality or services), each of which involves a different set of policy considerations. One may have reservations about the usefulness of such a sharply compartmented classification in analysing the determination of specific prices, where, in practice, a compound of policy considerations is frequently involved; however, it does serve to underline the point that no single general principle or technique is the rule in all (or most) areas of industrial pricing. Indeed, the techniques of price setting are apparently so various and reflect such a complex blend of marketing situations that valid generalization is difficult.

Even if it were possible, following Clemens and Hawkins, to subsume most pricing policies under the heading of marginal pricing, its realistic application would, as Clemens suggests, involve elements of flexibility not present in the precise formulations common in economic analysis. The desirability of such adaptability and flexibility in the price-making process to accommodate a variety of situations in a market as well as changing business conditions has often been emphasized[1], but it places obvious difficulties in the path of using the marginal cost approach to distinguish discriminatory from non-discriminatory prices with anything approaching mathematical precision.

Brief reference should also be made to the view that in analysing cases of price discrimination reliance should be placed on long-run marginal cost (roughly equivalent, according to Adelman,[2] to short-run average cost) rather than on short-run marginal cost. It has already been suggested that the customary interpretation of short-run marginal cost will not in all cases provide the best outcome. However, the view under consideration goes much beyond this position. Public policy, it is argued, should be concerned with "persisting relationships: discount schedules, customary allowances and the like."[3] In such cases the relevant cost measure is said to be long-run marginal cost - which, apart from minor items such as the costs of organizing the firm, comes to much the same thing as long-run average cost.

One of the implications of this position is that short-run price behaviour is not a matter of concern for public policy. To some extent this argument is undoubtedly sound; not every passing example of price discrimination merits attention. Indeed, the Canadian legislation exempts occasional discrimination from its prohibitions and condemns only "a practice of discriminating". However, "temporary" discrimination has been used in the past, and not improbably will be used in the future, with detrimental effect and it is by no means certain that such cases should be analyzed on a long-run marginal cost basis. In general, it would seem to be undesirable to adopt a single, unqualified position as to

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1. See, e.g., Malcolm P. McNair, "Marketing Functions and Costs and the Robinson-Patman Act", Law and Contemporary Problems, Vol. IV, No. 3, June, 1937, Passim.

2. M.A. Adelman, "The Consistency of the Robinson-Patman Act", Stanford Law Review, Vol. 6, No. 1, Dec., 1953.

3. Adelman, op. cit., p. 22.

the relevant cost measure to be employed. Perhaps the most that can be said is that that cost measure should be adopted which contributes most effectively to an understanding of the purpose and effect of the particular example of discrimination under consideration. A "long-run" approach to costs might well be appropriate in the analysis of a case of attempted monopolization; in other circumstances, a "shorter-run" approach might be more informative.

There follow a number of comments on price discrimination by some leading writers in this field.

Summary Comments on Price Discrimination by a Number of Economists

1. John Perry Miller, Unfair Competition (Harvard University Press, 1941):

"Public policy as interpreted by the courts, legislatures, or the Commission [The Federal Trade Commission] has never declared in favor of a one price policy or of a general policy of limiting price differentials to differences in cost. It has been recognized that price differentials of a discriminatory sort may be used to develop monopoly or they may substantially injure certain private business interests to the benefit of others. In such cases, public policy intervenes in order to promote fair competition and to prevent it from developing into unequal competition or monopoly. In short, discrimination is illegal when it coerces or excludes competitors or when it favors one group at the price of injury to others. So long as it keeps within these bounds business enterprise is free to determine the structure of prices as it wishes.

In drawing the limits to discrimination at these points public policy has failed to consider adequately the public interest in the structure of prices. It has failed to recognize that the public has an interest in the differences in the prices of a product sold to final consumers or to dealers who do not compete in resale, i.e. it has failed to recognize discrimination as a matter of differences in the degree of monopoly power which may adversely affect the allocation of economic resources."

(p. 192)

2. A.D.H. Kaplan, Small Business: Its Place and Problems (Committee for Economic Development, 1948):

"The issue of unfair competition . . . is not merely one of chain-store vs. independent-store retailing. It is the problem of integrated big business and its ability to play one sector of the economy against the other.

One test of desirable competition is whether or not it reduces the cost to the ultimate consumer. The apparent result of the operations of a chain with vertical and horizontal integration is to give its own customers lower prices than are obtainable in competing independent stores. But also to be reckoned with is the total community cost. If the low consumer prices at the chain store entail an absorption of losses by the parent company, for the benefit of its own retail outlets, and these losses are offset by profits at other levels that are taken from competing independent dealers, then the low prices at the chain store may be contributed in part by the higher prices that must be charged to consumers at the independent stores. Among those consumers that unwittingly pay that differential may be rural customers, consumers in neighborhoods not served by chains, and others whose interests will thus conflict with those of the consumers, stockholders and officers of the integrated combine. . . .

It seems almost inevitable that the chain, supermarket, mail-order house, or other large retail organization should reach out to acquire better control over the sources of supply for its retail outlets. As it moves into interlocking fields of production and distribution, the chain is bound at certain points to become the vendor to independent retailers who help to absorb the full capacity of the operation. At that point the small business may be squeezed out by receiving as an outsider less favorable terms than are afforded the chain's own outlets.

When the combine is the supplier as well as the competitor, the small competitor can easily be deprived of the opportunity to compete freely on the merit of his product and service. Such discrimination may also occur apart from the vertical integration, in the power of the chains through volume buying to command better terms than the individual merchant can obtain. It is the function of the FTC [The Federal Trade Commission] to separate the situations where

such advantages are the natural and legitimate economy of larger volume orders from those in which coercive economic power has been employed in the restraint of competition."

(pp. 196-7)

3. Joe S. Bain, Price Theory (New York, 1952):

In connection with "third-degree price discrimination", Professor Bain, after reviewing the general effects of such discrimination such as the charging of two or more prices instead of a single price, higher profits, and others referred to above, continues,

> "Fifth, the price-raising and output-restrictive effects of any monopoly remain, with the same general effects on allocation: price tends significantly to exceed marginal cost. Sixth, allocation is further affected in that under discrimination the relation of price to marginal cost will vary in different submarkets. Thus, whatever the general restrictive impact on industry output as a whole, there is a further tendency toward allocating too much of output to submarkets with more elastic demand and too little to submarkets with less elastic demand from the standpoint of aggregate welfare. Finally, it is probably the view of most people that the practice of charging a high price to John Smith and a lower one to Peter Jones for the same good is unethical or unjust; to borrow the words of Merriam-Webster, such a price difference is viewed as 'an unfair or injurious' distinction in treatment. Since those making policies in the market place must ultimately answer to public opinion, this value judgment must be seriously considered."

(p. 414)

And, with reference to chaotic discrimination, he says,

> "What is the impact on welfare of these types of chaotic price discrimination? Like any other sort of discrimination, they are open to attack as unjust or inequitable in that different buyers are treated unequally by a seller. Like other sorts of discrimination, they have adverse allocation effects. Unlike monopolistic discrimination, they may not enhance the joint profits of the oligopolistic sellers, and they may actually reduce them. And they may not be entirely inimical to the interests of buyers. To be sure, arbitrary price discrimination associated with geographical price formulae in general is a part of a collusive effort to maintain prices, and it may actually lead to higher total freight costs and

higher prices than more effective collusion and discrimination would. But chaotic discrimination emergent from secret price cutting in oligopoly is frequently a vehicle for lowering prices and profits, and perhaps the only workable vehicle in the absence of direct governmental control. Its unfavorable aspects, thus, may be counterbalanced in part or full, or over-balanced, by its favorable effects."

(pp. 431-2)

4. A.G. Papandreou, in Business Concentration and Price Policy (Princeton University Press, 1955):

"It is well known that public policy makers in the United States have not shown much concern over discriminatory practices that arise in the process of 'making-the-most' [independent maximization principle] except insofar as their effects on competitive structure and behaviour may be similar to those obtaining under the 'play-the-game' [collusion] and 'kill-the-rival' [predatory competition] principles. In sharp contrast to the attitude of policy makers, the economists have expended substantial effort in appraising the welfare implications of discriminatory practices arising from the 'make-the-most' principle. It must be stressed, nevertheless, that the economists' concern arises primarily from the fact that discrimination implies monopoly power, and it, in turn, implies a nonoptimal pattern of resource allocation.

The 'play-the-game' and 'kill-the-rival' principles of firm behavior lead to discriminatory practices that have been foremost in the thoughts of public policy makers. Our anti-trust law comes to grip with discrimination only insofar as its effects can be anticipated on the basis of 'kill-the-rival' and 'play-the-game' principles of behavior. In sharp contrast to the public policy makers' interest in this type of discrimination, the economic theorists' interest has been rather mild. This is probably due to the fact that they have been unable to evolve a satisfactory approach to behavior in oligopolistic markets where the 'play-the-game' and 'kill-the-rival' principles are apt to be useful for purposes of prediction."

(p. 439)

5. Corwin D. Edwards has summed up the arguments commonly advanced pro and con the Robinson-Patman Act, as follows:

"As to small business, we are told that the statute is an indispensable safeguard for the little concern; that the safeguard has not been very effective because mass distributors have found ways of escaping the impact of the law, particularly by integrating vertically or purchasing the entire output of certain producers; and that the statute has actually hurt small business by condemning important practices of voluntary chains and by unduly restricting the right to absorb freight.

As to the effect upon prices, we are told, on the one hand, that the law prevents competitive pressure from taking the form of special price concessions and forces them instead to become broad price reductions, so that downward price movements take place more readily than before and the average level of prices tends to be lower than before. But we are told, on the other hand, that inducements sufficient to bring about special concessions are often not sufficient to bring about general reductions in prices; that concessions to favored customers tend to spread and become general; and that, therefore, the elimination of the special concession reduces price flexibility and keeps prices higher than they would otherwise be.

As to the efficiency of marketing, we are told that the law fully preserves the elements of efficiency that may depend upon price difference, since it permits differentials that make due allowance for difference in cost, and that, in curbing price differences that do not reflect cost differences, the law attacks only predatory and wasteful marketing practices. Conversely, however, we are told that efficiency is impaired by the law because sellers are prevented from experimenting with their price structures unless every price differential can be justified by a cost difference, not only eventually but immediately, and under an accounting standard that is excessively strict."

"Twenty Years of the Robinson-Patman Act", The Journal of Business, The School of Business of the University of Chicago, Vol. XXIX, No. 3, July, 1956, pp. 158-9.

o. Joel B. Dirlam and Alfred E. Kahn, "Price Discrimination in Law and Economics", The American Journal of Economics and Sociology, Vol. II, No. 3, April, 1952:

"Taking a broader view, the antitrust agencies have played - albeit unconsciously - a positive role in functioning as

the only tribunals in an economic world characterized by unequal distribution of resources, where the underprivileged can be given a hearing. To use a homely illustration, if wage earners and employers had equal bargaining power, it would never have been necessary to set up machinery to promote collective bargaining in the labor field. Similarly, if all business firms had roughly the same financial resources, and enjoyed equal access to raw materials, investment funds, and other sources of supply, price discrimination would be of little public concern. But, just as in the field of labor, inequities are bound to lead to political action. The resultant intervention should not be condemned out of hand by economists if it can be made consistent with one of the cardinal principles of a free enterprise system - that businesses shall compete in such a way as to reward efficiency and efficiency only. A free enterprise system cannot continue to ignore discrepancies between its ideals and its realities. Nor can economic analysis, if it is to be anything other than an abstract exercise, afford to confine its attention to effects on resource use and competition."

(pp. 312-3)

7. Alfred Marshall, Industry and Trade (Third Edition):

"But unfortunately a discrimination, which belongs to legitimate constructive business, is not always capable of being distinguished clearly from one, which is strategic and may involve danger to the body politic. A strategic discrimination nearly always has some constructive value; and its apologists naturally put this into the foreground. It often happens that they alone have the knowledge required for assigning to these two elements their true relative values. The public, in doubt, may be compelled to acquiesce in some discriminations, the real purpose of which it suspects to be destructive: while it must prohibit others that may be constructive under some circumstances, but also may be applied to evil uses by routes which it is not easy to trace.

This matter is becoming increasingly serious with the continual growth of vast capitalistic aggregations. Thus, returning to the case of mineral oil, let us suppose that the greater part of the trade in it throughout a large district had fallen into the hands of a company, which desired to make its monopoly complete. It might watch for the appearance of

competitors with small means; and if allowed to discriminate it might destroy them by selling at a very low price in their immediate neighbourhood. But it could not afford to adopt this price everywhere: and if forced to maintain a single price (after due allowance for differences in costs of delivery), it would reach uniformity by ceasing to sell any oil at a very low price: that is, by raising the average price of its sales. And yet this result might be more in the public interest in the long run than that which would follow from opening the door to malignant discrimination; which might begin by suppressing nascent competition, and end by raising prices generally, though not necessarily to a uniform level, throughout the whole district."

(pp. 417-8)

## CHAPTER III

## GROCERY DISTRIBUTION IN CANADA

### 1. The Grocery Trade in Canada

The marketing structure for the distribution of groceries has been going through a period of more or less rapid change for at least the past three decades. Recently the pace appears to have accelerated. The basic functions involved in the movement of goods from the producer to the consumer have not been reduced; on the contrary, in some respects they have been increased, such as in the better grading and packaging of fresh produce. The notable changes in methods of distribution, however, have related to shifts in the division of the services and their cost among retailer, wholesaler and producer. The producer, whether manufacturer or processor, has, for example, sometimes attempted to shorten or make more certain his route to the retailer by by-passing the wholesaler and making his sales through manufacturers' sales branches or manufacturers' agents. Certain retail organizations have set up their own wholesale facilities in connection with a chain of retail outlets and make their purchases direct from the producer. Wholesalers, attempting to maintain their position against these flanking movements, have expanded their operations through mergers and have become associated with groups of retailers, also hard-pressed by the changes, to form voluntary or co-operative chains. A few wholesalers have adopted cash-and-carry methods of sale to meet the needs of some of the smaller retailers. There has also been a tendency for wholesalers to broaden the range of products offered to the retail trade. Such specialists as the tobacco wholesaler and the coarse paper wholesaler have found their fields invaded by the "general line" wholesaler, and have responded, in some cases, by putting their own operations on a more general basis. Each of the major distributive groups has attempted to install itself more firmly in the consumer's favour by advertising and promoting respectively, manufacturers' brands, wholesalers' (or voluntary group) brands, and retailers' (e.g., chain store) brands.

In the sector of retail distribution, the increasing size of supermarkets, based in the first place on the economies of large-scale self-service selling, has placed emphasis on the use of

more and more powerful attractions to pull traffic past the lengthening rows of shelves. Promotional devices of great variety have been used; indeed, some observers have referred to this development as "gimmick selling".[1] The huge volume of sales moving through supermarkets has naturally enough given rise among manufacturers to strenuous competition for preferred selling positions in such outlets - often called "the battle for shelf space". Advertising and other promotional allowances are apparently playing an important role in this "battle", as are more colourful packaging and other methods of attracting the shopper's attention. One observer recently remarked, "Shoppers rely on self-serve shelves and displays to remind them of their needs, and what they don't see they won't buy. Special display at point of purchase had been known to increase sales of a product as much as 400% through more impulse buying."[2] To some writers this emphasis on strategic display positions and the like suggests that price competition, long the hallmark of grocery distribution, is being displaced by cost-increasing promotional expenditures ranging from trading stamps, through retailer sales contests, premiums in packages, payments for shelf space, and the whole gamut of advertising devices. Others consider that increased promotional costs are likely to be of short-run importance and that they will set the stage for renewed emphasis on price competition.

These and other changes have involved problems of adjustment whose impact it is difficult to assess. Up to 1951, the latest date for which detailed statistics are available, there was little in the number of establishments to suggest a worsening of the position of either grocery wholesalers or retailers. The number of establishments for "wholesalers proper" in the "groceries and food specialties" division of trade increased from 561 in 1930, to 743 in 1941, to 835 in 1951. The number of grocery and combination retail stores rose from 23,328 in 1930 to 27,985 in 1941, to 34,548 in 1951; and over this same period the number of stores in chains declined substantially (although their average size increased). It may be that the "newer" methods of distribution have gained an important proportion of their patronage from the growth factor; certainly they have not had to compete with the "established" channels of distribution for an unchanged volume of trade. In fact,

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1. For some of the devices used in Canadian supermarkets, see "The Barnum of the Supermarkets", MacLean's Magazine, August 6, 1955, pp. 8-9.

2. "Sees Double Drain on Advertising Programs", Canadian Grocer, May 1, 1956, p. 18.

the figures on the division of retail sales of grocery and combination stores between "independent" and chain stores would suggest that up to 1951 this was largely the case. In 1930, the chains accounted for 26.1 per cent of total sales, in 1941 for 27.4 per cent, and in 1951 for 29.6 per cent. For the years after 1951, only estimated figures are available but these support the conclusion of casual observation that within the past few years the chains have begun to make substantial inroads into the independents' position. By 1955, for example, the chains had increased their share to an estimated 39.6 per cent. Detailed statistical evidence of the extent of this shift in retail trade will, however, become available only at the next census of distribution (1961).

If all goods sold in Canada passed in orderly fashion from manufacturer to wholesaler to retailer, it would be possible to follow the flow of trade with some precision and to make exact comparisons of costs and functions at the different stages of distribution. However, goods manufactured in Canada may go, in part, to exports, in part, to other manufacturers as equipment and supplies, in part, to wholesalers, and, in part, to retailers. Wholesalers handle imports as well as domestic products and make sales to manufacturers, to other wholesalers, to retailers and to final consumers. Hence, the data and analysis of trade at the wholesale and retail levels which follow should be regarded as providing a general picture of distribution in the grocery trade rather than an intensive and exhaustive survey of functions that are strictly defined and clearly differentiated.

## 2. Wholesale Trade

Data on wholesale distribution in the food industry are reported under two main headings in the 1951 census of distribution: "food products (except groceries) and tobacco"[1] and "groceries and food specialties". Under the former heading are included the following kinds of wholesalers: confectionery, soft drinks and tobacco; dairy and poultry products; fish and sea foods; frozen or frosted foods; fruits and vegetables (fresh); meats and meat products: produce; other food products except groceries. The "groceries and food specialties" division includes wholesalers in: groceries (general line); grocery specialties - biscuits and other bakery products, canned foods, coffee, tea, spices and cocoa, flour,

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1. In earlier census reports this heading was broken down into "food products (except groceries)" and "tobacco and tobacco products (except leaf)".

sugar, and other grocery specialties. Products sold by both of these broad classes of wholesaler are commonly found in stores in the divisions of retail trade which will be reviewed below, that is, grocery and combination stores. However, wholesalers in the "food products (except groceries) and tobacco" division sell to a much wider range of retailers than the wholesalers in the second category who are likely to be restricted more closely to, and who account for a relatively high proportion of, sales to retail grocery and combination stores. Hence, to limit the analysis that follows to wholesalers in "groceries and food specialties", although it will not provide a complete picture of the size, operating costs and the like of all wholesale suppliers in the food fields, will bring out, insofar as information is available, the major features of the operations of the principal suppliers to retail grocery and combination stores.

Within the broad class of wholesale distributors of "groceries and food specialties", there are three major subdivisions of wholesalers: wholesalers proper, manufacturers' sales branches and offices, and agents and brokers. As is clear from the data in the accompanying table, significant changes have occurred in the position of these three groups. Between 1930 and 1951 the number of establishments in the wholesalers proper category increased almost 50 per cent, their dollar sales in 1951 were four times as great as in 1930, and their share of total sales for the three groups rose steadily from 56 per cent to 66 per cent. Manufacturers' sales branches and offices increased in number by 44 per cent from 1930 to 1951, their dollar sales in 1951 were about 320 per cent of their 1930 level, and their percentage of sales for the three groups fell sharply from 25 per cent in 1930 to 20 per cent in 1941 but then recovered to 23 per cent in 1951. Agents and brokers enjoyed a considerable increase in numbers from 1930 to 1941 but this was followed by a sharp decline which almost exactly halved their numbers by 1951. Although their sales in dollar terms almost doubled between 1930 and 1951, their percentage share of total sales for the three groups, after remaining almost unchanged from 1930 to 1941, suffered a sharp falling off of almost 40 per cent from the latter year to 1951.

## Wholesale Trade

### Groceries and Food Specialties

| | | Number of Establishments | Sales $'000 |
|---|---|---|---|
| Wholesalers Proper* | - 1930 | 561 | 221, 216 (56%) |
| | - 1941 | 743 | 347, 472 (62%) |
| | - 1951 | 835 | 883, 273 (66%) |
| Manufacturers' sales branches and offices | - 1930 | 191 | 96, 586 (25%) |
| | - 1941 | 233 | 116, 038 (20%) |
| | - 1951 | 275 | 307, 436 (23%) |
| Agents and brokers | - 1930 | 180 | 75, 574 (19%) |
| | - 1941 | 259 | 102, 367 (18%) |
| | - 1951 | 130 | 145, 029 (11%) |

Note: In 1930, although not for later years, wholesale sales of chain store warehouses were shown. In that year there were 24 establishments with sales of $67, 894, 000. This amount is not, of course, included in the sales of "wholesalers proper."

Source: Census of Distribution

*Sales of "wholesalers proper" can be broken down into sales by wholesalers of "groceries (general line)" and of "grocery specialties". Sales were divided between these two categories as follows:

| | Groceries (general line) | Grocery Specialties |
|---|---|---|
| 1930 | 88.5% | 11.5% |
| 1941 | 77.8% | 22.2% |
| 1951 | 86.5% | 13.5% |

The description of these two sub-categories of wholesaler varies somewhat in census reports. In 1931 and 1941 they were titled "Groceries (general line)" and "Food and grocery specialties"; in 1951, the description of the first sub-category was the same but the latter was changed to "Grocery specialties".

Data are available on post-1951 sales only for wholesalers proper. This group, as is indicated in the table below, continued to enjoy a rapid rate of growth in sales with an increase of almost $400, 000, 000 between 1951 and estimated 1956 levels.

Wholesale Trade
(Wholesalers Proper)

| | | Number of Establishments | Sales $'000 |
|---|---|---|---|
| Groceries and food specialties | | | |
| (actual) | 1930 | 561 | 221, 216 |
| (actual) | 1941 | 743 | 347, 472 |
| (actual) | 1951 | 835 | 883, 273 |
| | 1953 | - | 944, 999 |
| | 1954 | - | 1, 036, 220 |
| | 1955 | - | 1, 139, 659 |
| (Prelim.) | 1956 | - | 1, 246, 104 |

Source: Date for 1930, 1941, 1951 from the Census of Distribution; for 1953 through 1956 the figures are estimates from Wholesale Trade, D.B.S.

Although estimates for grocery and combination stores for 1956 are not yet available, on the basis of sales in 1955, retail sales increased from 1951 by about 27 per cent, whilst sales by wholesalers proper in the field of groceries and food specialties increased by about 29 per cent through the same period. Hence, despite the rapid growth of corporate chains (see below, section on "Retail Trade"), wholesalers proper appear in recent years to be maintaining their position.[1]

## Sales by Size of Establishment

Small units, although of diminishing importance, are still fairly numerous among wholesalers proper engaged in

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1. Some grocery wholesalers are associated with corporate chain stores, and sales reported by the former group may reflect, in greater or lesser degree, sales by the affiliated chain. Data are not available to assess the significance of this relationship in the sales increases here referred to.

distributing groceries and food specialties. In 1930, 12.8 per cent of all such establishments had annual sales of less than $25, 000 and such sales accounted for about 4/10ths of 1 per cent of total sales for this category of wholesaler. In 1941, 23.5 per cent of all establishments, accounting for sales of about 1/2 of 1 per cent of the total, were found in the same sales size-class. By 1951, units with sales of this volume had declined to 7.2 per cent of total units in the group with sales of about 1/10 of 1 per cent of the total for the group.[1]

Units with annual sales of less than $500, 000 still account for a very limited proportion of total sales. In 1930, establishments falling within this limit of sales accounted for almost 75 per cent of all units and their sales amounted to about 30 per cent of the total for the group. In 1941, about 71 per cent of units came within the limit under discussion and they accounted for about 21 per cent of total sales. By 1951, numbers had declined to about 47 per cent of the total and their share of sales had fallen to about 7.5 per cent.

The establishments with sales of $1, 000, 000 and over clearly dominate this sector of wholesale trade. In 1951, with 35 per cent of the number of establishments, they accounted for 80 per cent of total sales. In 1941, with 12.7 per cent of total establishments they had 54 per cent of sales; and in 1931, with 9.8 per cent of establishments they had 44.2 per cent of sales.

The above figures apply to wholesalers proper of groceries and food specialties as a group. This group can be broken down into wholesalers proper of "groceries (general line)" and of "food and grocery specialties".* The accompanying table reports the breakdown by size of business in detail.

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1. No detailed information is available showing the nature of the operations of these smaller categories of wholesale trade. Some are apparently associated with retail organizations of moderate size, some are new-comers hopeful of becoming established on a larger scale, some may be affiliated with industrial concerns requiring grocery products to supply working crews in remote places, others may be institutional purchasers, and the like. The numbers, therefore, of such wholesalers may have little relevance to the question of how many small wholesalers are still engaged in distribution to retail outlets.

* See Footnote 2, Table, page 60.

WHOLESALE TRADE, BY MAJOR TYPE OF OPERATION AND KIND OF BUSINESS AND BY SIZE OF BUSINESS
(Wholesalers Proper)

| Kind of business | | All establishments | | - $10,000 [1] | | $10,000 to $24,999 | | $25,000 to $49,999 | | $50,000 to $99,999 | | $100,000 to $199,999 | | $200,000 to $299,999 | | $300,000 to $399,999 | | $400,000 to $499,999 | | $500,000 to $999,999 | | $1,000,000+ | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | No. | Sales | No. | Sales | No. | Sales | No. | Sales | No. | Sales | No. | Sales | No. | Sales | No. | Sales | No. | Sales | No. | Sales | No. | Sales |
| | | | $'000 | | $'000 | | $'000 | | $'000 | | $'000 | | $'000 | | $'000 | | $'000 | | $'000 | | $'000 | | $'000 |
| Groceries and[2] food specialties | 1951 | 835 | 883,273 | 18 | 82 | 42 | 729 | 54 | 1,891 | 57 | 4,093 | 72 | 10,256 | 66 | 16,248 | 44 | 15,375 | 37 | 16,473 | 152 | 110,637 | 293 | 707,490 |
| | % | (100) | (100) | (2.2) | (0.01) | (5.0) | (0.09) | (6.5) | (0.2) | (6.8) | (0.4) | (8.6) | (1.2) | (8.0) | (1.8) | (5.3) | (1.7) | (4.4) | (1.9) | (18.2) | (12.5) | (35.0) | (80.0) |
| | 1941 | 743 | 347,472 | 83 | 435 | 92 | 1,508 | 50 | 1,774 | 65 | 4,683 | 85 | 12,679 | 64 | 16,096 | 47 | 16,342 | 43 | 19,384 | 120 | 87,249 | 94 | 187,322 |
| | % | (100) | (100) | (11.0) | (0.1) | (12.5 | (0.4) | (6.7) | (0.5) | (8.7) | (1.35) | (11.0) | (3.6) | (8.6) | (4.6) | (6.3) | (4.7) | (5.8) | (5.6) | (16.1) | (25.0) | (12.7) | (54.0) |
| | 1930 | 561 | 221,216 | - | - | 72 | 946 [1] | 67 | 2,413 | 55 | 4,002 | 93 | 13,935 | 51 | 12,437 | 48 | 16,521 | 33 | 14,808 | 87 | 58,469 | 55 | 97,685 |
| | % | (100) | (100) | - | - | (12.8) | (0.4) | (11.9) | (1.1) | (9.8) | (1.8) | (16.5) | (6.3) | (9.1) | (5.6) | (8.5) | (7.5) | (5.9) | (6.7) | (15.5) | (26.4) | (9.8) | (44.2) |
| Groceries [2] (general line) | 1951 | 610 | 762,967 | 7 | 19 | 7 | 117 | 18 | 620 | 20 | 1,441 | 38 | 5,531 | 53 | 12,965 | 38 | 13,366 | 31 | 13,806 | 138 | 100,818 | 260 | 614,287 |
| | % | (100) | (100) | (1.1) | (0.002) | (1.1) | (0.02) | (2.9) | (0.1) | (3.3) | (0.2) | (6.2) | (0.7) | (8.7) | (1.7) | (6.2) | (1.8) | (5.1) | (1.8) | (22.6) | (13.2) | (42.6) | (80.5) |
| | 1941 | 413 | 270,227 | 6 | 35 | 14 | 257 | 12 | 485 | 28 | 2,123 | 57 | 8,816 | 42 | 10,707 | 36 | 12,571 | 35 | 15,818 | 107 | 77,558 | 76 | 141,857 |
| | % | (100) | (100) | (1.5) | (0.01) | (3.4) | (0.1) | (2.95) | (0.2) | (6.8) | (0.8) | (13.8) | (3.3) | (10.2) | (3.96) | (8.7) | (4.7) | (8.5) | (5.9) | (25.9) | (28.7) | (18.4) | (52.5) |
| | 1930 | N.A | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Food and [2] grocery specialties | 1951 | 225 | 120,306 | 11 | 63 | 35 | 612 | 36 | 1,271 | 37 | 2,652 | 34 | 4,725 | 13 | 3,283 | 6 | 2,009 | 6 | 2,667 | 14 | 9,819 | 33 | 93,203 |
| | % | (100) | (100) | (4.9) | (0.05) | (15.6) | (0.5) | (16.0) | (1.1) | (16.4) | (2.2) | (15.1) | (3.9) | (5.8) | (2.7) | (2.7) | (1.7) | (2.7) | (2.2) | (6.2) | (8.2) | (14.7) | (77.5) |
| | 1941 | 330 | 77,245 | 77 | 400 | 78 | 1,251 | 38 | 1,289 | 37 | 2,560 | 28 | 3,863 | 22 | 5,389 | 11 | 3,771 | 8 | 3,566 | 13 | 9,691 | 18 | 45,465 |
| | % | (100) | (100) | (23.3) | (0.5) | (23.6) | (1.6) | (11.5) | (1.7) | (11.2) | (3.3) | (8.5) | (5.0) | (6.7) | (6.98) | (3.4) | (4.9) | (2.4) | (4.6) | (3.9) | (12.5) | (5.5) | (58.9) |
| | 1930 | N/A | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |

1. In 1930 the smallest size-class was that with sales "Under $25,000".

Source: Census of Distribution, D.B.S.

2. These classifications are those employed by D.B.S. It would appear that the possibility of confusion would be reduced if the third classification, "Food and Grocery Specialties", were described as "Food Specialties".

One point that is of special interest is the concentration of numbers in the small sales size-classes in the "food and grocery specialties"* group and in the largest sales size-class in the "groceries (general line)" group. In the former, in 1951, the three smallest sales size-classes (less than $50, 000) accounted for 36.5 per cent of numbers and 1.65 per cent of sales, whilst in the latter ("groceries (general line)") the same size-classes included only about 5.1 per cent of numbers with only slightly more than 1/10th of 1 per cent of sales. Establishments with sales of $1, 000, 000 and over in the "food and grocery specialties" group accounted for about 14.7 per cent of numbers and 77.5 per cent of sales, whilst in the same size-class of the "groceries (general line)" group 42.6 per cent of the numbers made 80.5 per cent of the sales. In general, the small units tend to be relatively (and absolutely despite the smaller group total) more numerous and the large units to be relatively fewer (and with larger average unit sales) in the case of the "food and grocery specialties" distributors than in the case of the "groceries (general line)" distributors.

It will be recalled that the data in the table on page 57 indicated that wholesalers proper of food and grocery specialties improved their position appreciably relative to those selling general line groceries from 1930 to 1941 - their share rose from 11.5 per cent of the total to 22.2 per cent - but then fell back to a point where it was 13.5 per cent in 1951, thus displaying no significant trend.

Sales by Number of Marketing Units

The accompanying table classifies wholesale establishments by the number under the same ownership. Separate breakdowns are provided for each of the three major types of wholesale outlet for groceries and food specialties.

The largest "chains" of wholesale establishments in the "wholesalers proper" category have "26-50 units". "Chains" of this size do not, however, account for any large proportion of total sales. They accounted, in 1951, for 7.7 per cent

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* See Footnote 2 Table, page 60.

of total numbers and 12.1 per cent of total sales. This was a reduction from the 1941 level both in the percentage of numbers (9.8 per cent) and, more markedly, of sales (19.1 per cent). As compared with 1930 the percentage of numbers has fallen sharply but there has been no significant change in the percentage of sales. Sales per unit in these large "chains" in 1951 amounted to about $1,680,000. The ownership groups of wholesalers proper with "11-25 units" accounted for a very much larger proportion of both numbers and sales than their larger counterparts, and groups in "chains" of this size showed a striking increase in their share of the trade from 1941 to 1951, rising from 10.5 per cent to 26.1 per cent. Average per unit sales for such "chains" in 1951 were about $1,770,000. The single-unit firms accounted, in 1951, for 63.4 per cent of all "wholesalers proper" and for 41.4 per cent of sales. This was a moderate reduction from the percentage of numbers accounted for by this group in 1941 (69.4 per cent) but no change in the percentage of sales (41.0 per cent). The relationships were reversed in a comparison with 1930 figures - the numbers percentage was unchanged (63.3 per cent) and the sales percentage was higher (51.2 per cent). Average unit sales in 1951 were about $690,000.

## WHOLESALE TRADE BY NUMBER OF MARKETING UNITS

(Number of establishments under same ownership)

| Type of operation and kind of business | | All establishments | | Single-Unit establishments | | 2 units | | 3 units | | 4-5 units | | 6-10 units | | 11-25 units | | 26-50 units | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Groceries and food specialties | | No. | Sales | No. | Sales | No. | Sales | No. | Sales | No. | Sales | No. | Sales | No. | Sales | No. | Sales |
| | | | $'000 | | $'000 | | $'000 | | $'000 | | $'000 | | $'000 | | $'000 | | $'000 |
| Wholesalers proper | - 1951 | 835 | 883,273 | 529 | 365,801 | 35 | 44,509 | 11 | 11,138 | 44 | 83,959 | 22 | 39,532 | 130 | 230,929 | 64 | 107,405 |
| | % | (100) | (100) | (63.4) | (41.4) | (4.2) | (5.0) | (1.3) | (1.3) | (5.3) | (9.5) | (2.6) | (4.5) | (15.6) | (26.1) | (7.7) | (12.1) |
| | - 1941 | 743 | 347,472 | 516 | 142,553 | 29 | 23,543 | 19 | 10,327 | 35 | 44,167 | 32 | 24,006 | 39 | 36,525 | 73 | 66,351 |
| | % | (100) | (100) | (69.4) | (41.0) | (3.9) | (6.8) | (2.6) | (3.0) | (4.7) | (12.7) | (4.3) | (6.9) | (5.2) | (10.5) | (9.8) | (19.1) |
| | - 1930 | 561 | 221,216 | 355 | 113,323 | 31 | 13,490 | 44 | 31,871[1] | - | - | 47 | 33,797[2] | - | - | 84 | 28,735[3] |
| | % | (100) | (100) | (63.3) | (51.2) | (5.5) | (6.1) | (7.8) | (14.4) | - | - | (8.4) | (15.3) | - | - | (15.0) | (13.0) |
| Manufacturers' sales branches and offices | - 1951 | 275 | 307,436 | 13 | 9,732 | 19 | 10,920 | 6 | -* | 62 | 112,522 | 56 | 50,880 | 45 | 70,421 | 74 | -* |
| | % | (100) | (100) | (4.7) | (3.2) | (6.9) | (3.6) | (2.2) | - | (22.6) | (36.6) | (20.2) | (16.6) | (16.4) | (22.9) | (26.9) | - |
| | - 1941 | 233 | 116,038 | 17 | 9,242 | 14 | 4,840 | 16 | 9,413 | 24 | 19,526 | 14 | 23,443 | 65 | 41,017 | 83 | 8,557 |
| | % | (100) | (100) | (7.3) | (8.0) | (6.0) | (4.2) | (6.9) | (8.1) | (10.3) | (16.8) | (6.0) | (20.2) | (27.8) | (35.4) | (35.6) | (7.7) |
| | - 1930 | N/A | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Agents and brokers | - 1951 | 130 | 145,029 | 82 | 78,239 | 5 | -* | 4 | -* | 12 | 3,251 | 27 | 46,913 | | | | |
| | % | (100) | (100) | (63.0) | (54.0) | (3.8) | - | (3.1) | - | (9.2) | (2.2) | (20.8) | (32.4) | | | | |
| | - 1941 | 259 | 102,367 | 220 | 68,785 | 12 | 6,750 | - | - | - | - | 27 | 26,832 | | | | |
| | % | (100) | (100) | (85.0) | (66.7) | (4.6) | (6.6) | - | - | - | - | (10.4) | (26.7) | | | | |
| | - 1930 | N/A | - | - | - | - | - | - | - | - | - | - | - | | | | |

1. Covers 3-5 units.
2. Covers 6-25 units.
3. Covers "over 25 units".

* Indicates that figures are withheld to avoid disclosing individual operations, but these are included in the totals.

Source: Census of Distribution, D. B. S.

The "manufacturers' sales branches and offices" wholesale outlets provide some interesting comparisons and contrasts. Those "chains" with "26-50 units" accounted in 1941 for a high percentage of units (35.6 per cent) but a very low percentage of sales (7.7 per cent). Although complete details are not obtainable for 1951, the available data point to a similar result. Average unit sales for "chains" of this size in 1941 amounted to only $103,000. "Chains" of the next three smaller sizes (11-25 units, 6-10 units and 4-5 units) accounted in both 1941 and 1951 for the major part of total sales: 72.4 per cent in 1941 and 76.1 per cent in 1951. In 1941, however, these three size-classes covered 44.1 per cent of total numbers whereas in 1951 they covered 59.2 per cent. In 1941, average unit sales in these three classes were at their maximum for "chains" having "6-10 units" and reached approximately $1,670,000; in 1951, they were highest for "chains" with "4-5 units" at approximately $1,810,000. In contrast with "wholesalers proper" there were comparatively few units in the "single-unit establishments" category - only 7.3 per cent of numbers with 8.0 per cent of sales in 1941, and 4.7 per cent of numbers with 3.2 per cent of sales in 1951. Average unit sales in 1941 were about $540,000 and in 1951 $750,000. These averages, although very much smaller than those for the medium-size "chains", are several multiples of the average for the largest "chains", those with "26-50 units". How far these differences may be correlated with the operations of manufacturers engaged in different types of production it is impossible, from the available information, to say.

For all practical purposes, "agents and brokers" fall into two ownership groups; "single-unit establishments" and "chains" of "6-10 units". In 1941, together they accounted for 93.4 per cent of total sales, and in 1951 for 86.4 per cent. The single units in 1941 accounted for 85.0 per cent of total numbers and 66.7 per cent of total sales; by 1951 they constituted 63.0 per cent of numbers and 54.0 per cent of sales. Average unit sales increased three-fold - from $312,000 in 1941 to $954,000 in 1951, and actual numbers of single-unit establishments in 1951 were only about 37 per cent of their level a decade before.

The numbers in the 6-10 unit "chains" were the same in both censal periods - 27, although they constituted 10.4 per cent of the total in 1941 and 20.8 per cent in 1951. Their share of total sales increased only moderately from 26.7 per cent in 1941 to 32.4 per cent ten years later. Average unit sales increased

over the decade but much less notably than for single units: in 1941 they were just under $1,000,000 and by 1951 had increased to about $1,737,000; that is they were approximately three times the average unit sales for single-unit establishments in 1941 but less than double such sales in 1951.

One of the most striking features of the data on the number of establishments under the same ownership is the marked increase from 1941 to 1951 in the share of total trade in the "wholesalers proper" group going to chains with 11 to 25 units. With the exception of single-unit establishments, all groups (including the largest size-class having 26-50 units) lost more or less substantially in their share of the trade to this single size ownership class.

## Operating Results

The operating results in the accompanying table apply to "wholesalers proper" and are reported by size of firm. Although too much importance should not be attached to small changes in profit and expenses percentages, since the data are not derived from returns prepared by identical firms each year, nevertheless broad tendencies thrown up by the data may be considered to possess a high degree of validity.

In 1947 firms with sales of less than $1,000,000 had the lowest gross profit percentage and those with sales in the $5,000,000 to $9,999,999 size-class had the highest. By 1955 firms in the smallest size-class had the highest gross profit (and it was also the only size-class that had experienced an increase, even though a slight one, over the years 1947-55), and firms in the largest size-class, $10,000,000 and over, had the lowest gross profit (and this class had also experienced the most substantial decline - 1.29 percentage points).

## Operating Results of Grocery Wholesalers

(By size of firm)

| Item | | Under $1,000,000 | $1,000,000 to $4,999,999 | $5,000,000 to $9,999,999 | $10,000,000 and over |
|---|---|---|---|---|---|
| Number of firms | -1947 | 34 | 50 | 6 | 5 |
| | -1951 | 40 | 61 | 7 | 5 |
| | -1955 | 34 | 61 | 6 | 7 |
| Gross Profit[1] | -1947 | 7.74 | 8.03 | 8.35 | 8.06 |
| | -1951 | 7.82 | 7.92 | 8.62 | 7.77 |
| | -1955 | 7.92 | 7.60 | 7.57 | 6.77 |
| Total operating expenses | -1947 | 6.35 | 6.34 | 6.71 | 6.35 |
| | -1951 | 7.11 | 6.97 | 7.14 | 6.98 |
| | -1955 | 7.66 | 6.96 | 7.06 | 6.58 |
| Net operating profit | -1947 | 1.39 | 1.69 | 1.64 | 1.71 |
| | -1951 | 0.71 | 0.95 | 1.48 | 0.79 |
| | -1955 | 0.26 | 0.64 | 0.51 | 0.19 |
| Non-trading income | -1947[2] | 0.29 | 0.34 | 0.26 | 0.65 |
| | -1951 | 0.27 | 0.38 | 0.08 | 1.17 |
| | -1955 | 0.30 | 0.33 | 0.44 | 1.02 |
| Non-trading expense | -1947 | - | - | - | - |
| | -1951[3] | 0.08 | 0.10 | 0.02 | 0.13 |
| | -1955 | 0.09 | 0.14 | 0.29 | 0.09 |
| Net profit before income tax deduction | -1947 | 1.68 | 2.03 | 1.90 | 2.36 |
| | -1951 | 0.90 | 1.23 | 1.54 | 1.83 |
| | -1955 | 0.47 | 0.83 | 0.66 | 1.12 |

1. Data on profit and expenses expressed as a per cent of net sales.
2. Shown as "Other trading income" in 1947 and 1951.
3. Shown as "Miscellaneous expense" in 1951.

Source: D.B.S.

Operating expenses in 1947 were almost identical for three of the four size-classes; the remaining class ($5,000,000 to $9,999,999) being only about three-tenths of a percentage point above the others. By 1951, the range had widened very considerably and the percentage figure had increased for all size-classes. The minimum operating expenses percentage in 1955 was found in the largest sales size-class and the maximum in the smallest size-class.

Net operating profit was highly uniform in 1947 for the three largest sales size-classes (1.64 per cent to 1.71) and only moderately lower for the firms with sales "under $1,000,000". By 1955, however, a surprising change in the level of the net operating profit had taken place. The general level had fallen from the range of 1.39 to 1.71 per cent to 0.19 to 0.64 per cent. The largest sales size-class saw its percentage fall from 1.71 per cent (the maximum) in 1947 to 0.19 per cent (the minimum) in 1955

The trend of non-trading income did something, however, to improve the position of firms in the largest sales size-class. "Non-trading income" refers to income obtained from such sources as cash discounts, dividends or investment income, and particularly dividends from subsidiaries, interest earned, rental revenue and bad debts recovered. Income from these sources was highest in 1947 for the firms having sales of $10,000,000 and over (0.65 per cent) and ranged between 0.26 per cent and 0.34 per cent for the other sales size-classes. By 1955, the firms in the largest sales size-class had experienced a substantial rise in this type of income from 0.65 per cent to 1.02 per cent, whilst the two smallest size-classes remained unchanged and the second largest size-class had a moderate increase.

Net profit before income tax showed a striking decline for firms in all sales size-classes from 1947 to 1955. The largest percentage rate was received by firms with sales in the $10,000,000 and over class in both years, but the 1955 figure was less than half that for 1947. The other size-classes experienced even more drastic reductions, notably firms in the smallest size-class. It is clear that the eight-year period under review was one in which wholesale grocers made major adjustments in their methods of operation to meet the pressures arising from new systems of grocery distribution. It is also clear that operating margins have become so slender that favourable or unfavourable differentials of 1/4 to 1/2 of a percentage point may make the difference between success and failure.

## 3. Retail Trade[1]

Sales of grocery and combination stores in 1955 amounted to $2, 429, 581, 000 or 18.5% of total retail sales for all trades of $13, 111, 895, 000. In absolute terms, sales of grocery and combination stores have increased from $405, 404, 000 in 1930 to an amount six times as great in 1955, and throughout this period have constituted the leading category of retail sales. Percentagewise, this category of retail stores has tended in recent years to account for a growing share of total sales. In 1930, grocery and combination store sales accounted for 14.8% of the total, and for some years their share fluctuated between 15 and 16%. For 1951 through 1955 the figures have been in the neighbourhood of 18-19%; for example, in 1954 they reached 18.9% and in 1955 fell back slightly to 18.5%. It is of some interest to note that in the early years of the period under review department stores constituted second largest category of retail outlet, accounting for 13.0% of total sales in 1930. By 1955, however, their share of sales had fallen to 8.8 per cent which left them in third position behind the category, "motor vehicle" retailers, which had risen from third place with 9.2% in 1930 to 18.1% in 1955.

Through this period of rapidly rising sales, the number of grocery and combination stores also rose substantially, although far short of the increase shown by sales. From 23, 328 stores in 1930, numbers increased moderately to 27, 985 in 1941 and somewhat more sharply to 34, 548 stores in 1951. The increase in numbers occurred entirely in the "independent store" category; indeed, chain stores actually experienced a decline both in number of chains and in number of stores. In 1930 there were 67 chains in the grocery and combination stores category with an over-all average[2] of 2, 004 stores (and a maximum of 2, 127 stores). The largest number of chain stores was reached in 1934 when 74 chains had an average of 2, 159 stores (and a maximum of 2, 239 stores). From this peak there set in a fairly steady decline in numbers, until in 1955 there were only 35 chains accounting for an average of 1, 166 stores (and 1, 256 at the maximum) - little more than 50 per cent of their numbers twenty-five years earlier.

1. The statistics in this section, unless otherwise indicated, are taken from publications of the Dominion Bureau of Statistics

2. Obtained by averaging the number at the beginning, middle and end of the year.

## Chain Stores

Despite their smaller numbers, grocery and combination store chains have accounted for an accelerating share of total sales. In 1930, their sales amounted to 26.1 per cent of the total; by 1941, this had risen slightly to 27.4 per cent; by 1951, to 29.6 per cent, and by 1955 to 39.6 per cent (estimated)[1]. The percentage accounted for by chain stores varied greatly from province to province as is indicated in the following approximate figures for 1955:

| | No. of Chains | Stores (max.) | Chains % of total sales[2] |
|---|---|---|---|
| Atlantic Provinces | 8 | 84 | 16.5% |
| Quebec ......... | 6 | 212 | 30.2% |
| Ontario ......... | 16 | 555 | 54.5% |
| Manitoba ........ | 3 | 75 | 35.8% |
| Saskatchewan..... | 5 | 72 | 27.4% |
| Alberta ......... | 4 | 99 | 35.0% |
| British Columbia . | 6 | 159 | 39.4% |

This varying concentration of sales by provinces reflects the more basic fact that chain stores tend to be located in the larger urban centres. In 1955, almost 75 per cent of all chain store sales were made in centres of 30,000 population and over, although such cities accounted for only about 45 per cent of total sales in grocery and combination stores in the 1951 census. It is also of interest in this connection that chain store sales (grocery stores and combination stores) in 1955 in Halifax[3] accounted for about 42 per cent of total chain store sales in the Atlantic Provinces; in Montreal[3] for about 75 per cent of chain store sales in the province of Quebec; in Toronto[3] for about 36 per cent of chain store sales in Ontario; in Winnipeg[3] for about 86 per cent of chain store sales in Manitoba; in Regina for about 32 per cent of chain store sales in Saskatchewan; in Calgary[3] for about 44 per cent of chain stores in Alberta; and in Vancouver[3] for about 62 per cent of chain store sales in British Columbia.

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1. The figures are taken from Retail Chain Stores, 1955, D.B.S., p. G-21.

2. Based on data in Retail Trade, 1955, D.B.S., pp. F-8, F-9.

3. Metropolitan areas.

The relative importance of independent and chain stores in the grocery and combination store (with and without fresh meat) category for these cities is indicated for 1951 in the following table.

| | Percentage of Stores | | Percentage of Sales | |
|---|---|---|---|---|
| | Independent | Chain | Independent | Chain |
| Halifax | 92.0 | 8.0 | 58.4 | 41.6 |
| Montreal | 96.5 | 3.5 | 65.9 | 34.1 |
| Toronto | 91.5 | 8.5 | 42.8 | 57.2 |
| Winnipeg | 90.5 | 9.5 | 55.7 | 44.3 |
| Regina | 89.0 | 11.0 | 65.4 | 34.6 |
| Calgary | 87.5 | 12.5 | 46.6 | 53.4 |
| Vancouver | 92.7 | 7.3 | 54.6 | 45.4 |

Source: Census of Canada, Vol. VII, 1951, Table 14.

In view of the sharp increase between 1951 and 1955 in the percentage share of sales going to the chains, it is likely that the above figures will at present be more favourable to the chains.

Since chain-store methods of distribution appear to be best adapted to areas of highly concentrated population, the recent chain-store expansion in the larger urban centres has been carried out under favourable cost conditions; as these areas approach saturation of facilities, expansion into less populous areas is likely to encounter the resistance of some increase in costs.

Within the category of chain food stores there are large differences in the size of the chains and in the volume of their sales, as is indicated in the following classification of the number of units operated and the sales by chain size-category for 1955.

| Number of Units Operated | No. of Chains | No. of Stores (max.) | Total Sales Amount ($000) | Total Sales % of Total |
|---|---|---|---|---|
| Total, all food chains | 35 | 1,256 | 962,833 | 100.0 |
| 4-9 units | 17 | 84 | 21,697 | 2.3 |
| 10-99 units | 14 | 469 | 265,420 | 27.6 |
| 100 units and over | 4 | 703 | 675,715 | 70.1 |

The four chains with 100 and over stores per chain clearly dominate the group in terms of volume of sales (they also account for 27.8 per cent of sales for all grocery and combination stores in Canada), although, despite an increase over 1954 in number of outlets and in sales, the "Big Four's" percentage share of sales in 1955 fell off to 70.1 from 72.6 in 1954[1]. The chains in the "10-99 units" size, on the other hand, improved their position by moving up from 24.1 per cent of sales in 1954 to the figure of 27.6 per cent reported in the table for 1955.

The individual units of the chain stores display a wide range in annual sales volume. The following table indicates that the size-class with the largest number of units - approximately 34 per cent of all units - is that having sales of under $300,000, although such units accounted in 1955 for only 7.2 per cent of total sales. In 1954 the same sales-volume category had 7.7 per cent of total chain store sales. At the other extreme, units having sales of $2,000,000 and over whilst accounting for only about 7.5 per cent of all units in 1955, made 27.7 per cent of total sales - an increase from their 1954 share which stood at 26.1 per cent.

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1. The so-called "Big Five" chain stores - Loblaw Groceterias, Dominion Stores (including Thrift and Town and Country), Safeway Stores, Steinberg's and The Atlantic and Pacific Tea Co. - currently account for something approaching 90 per cent of total sales for all food chain stores in Canada.

Annual Unit Sales Volume for Chain Food Stores

1955

(Grocery Stores and Combination Stores)

| Annual Sales Range | No. of Stores (max.) | Total Sales $'000 | % of Total Sales |
|---|---|---|---|
| Total, all stores | 1,256 | 962,833 | 100.0 |
| $2,000,000 and over | 94 | 266,711 | 27.7 |
| $1,500,000 - $1,999,999 | 92 | 161,034 | 16.7 |
| $1,000,000 - $1,499,999 | 137 | 168,387 | 17.5 |
| $750,000 - $999,999 | 133 | 115,988 | 12.0 |
| $500,000 - $749,999 | 158 | 99,010 | 10.3 |
| $300,000 - $499,999 | 211 | 82,494 | 8.6 |
| Under $300,000 | 431 | 69,209 | 7.2 |

Finally, with reference to the position occupied by grocery and combination chain stores in retail distribution, it should be noted that in 1955 sales by this category of chain accounted for 40.9 per cent of retail sales by all types of chain stores in Canada. Second position was occupied by "alcoholic beverage stores" (wine stores, brewers' retail stores and government liquor stores) with 19.8 per cent of total sales. The operations of this latter group are characterized by a degree of government operation, government control and restriction upon entry that distinguish it from most other categories of retail trade. Were its sales to be eliminated from the total retail sales of chain stores, the share of the food chains would rise to just over 50 per cent of the remainder. The only other categories of chain store that contribute significantly to total sales are "variety stores" with 8.8 per cent of total (unadjusted) chain store sales, and "lumber and building material dealers" with 3.9 per cent. None of the remaining classes accounts for as much as 3 per cent of total chain store sales.

One of the characteristic features of chain-store operation is that each chain has one or more "central" warehouses to supply its retail outlets. In the case of a few chain organizations, the central warehouse organized as a separate corporate entity, engages in general wholesale trade, making sales

to independent retailers. Sometimes, also, there may be common control of corporate chains and grocery wholesalers, with limited integration. No statistical information is available on the extent of sales by such wholesalers or wholesale units. It is, however, widely understood that at least three of the larger wholesale grocery firms in Canada are controlled by and more or less closely integrated with, (or are under common financial control with) major chain stores. With respect to rates of profit and expenses on sales to the controlling chain and to independents, information is publicly available for one such wholesale-chain corporate grouping. The percentage rates on sales of grocery lines by the subsidiary wholesaler were:

| | On Sales to | |
|---|---|---|
| | Parent Chain | Independents |
| Gross profit | 2.88% | 6.95% |
| Expenses | 2.84% | 4.13% |
| Net Profit | 0.04% | 2.82% |

For the year to which these figures refer (1947), total grocery sales by the wholesale unit were divided as follows: independents, 55 per cent; the parent chain, 45 per cent. For later years, the parent chain's share was considerably larger.

It will be recalled that "gross profit" for wholesalers reporting to the DBS in 1947 ranged between 7.74 per cent and 8.35 per cent, and that "total operating expenses" ranged between 6.34 and 6.71 per cent, leaving "net operating profit" in the range between 1.39 and 1.71 per cent. It cannot, of course, be assumed that the three measures are computed on precisely the same basis in both cases, nor can it be assumed, as is frequently done, that, because of the known relationship between the chain and its subsidiary wholesaler, prices would have to be more favourable from that wholesaler than from competing wholesalers to induce retailers to buy from it. At least some - and these among the most important- competing wholesalers also have known affiliated retail groups of wide geographical distribution. Unaffiliated independents might very well regard all such wholesalers with equal favour, or disfavour. However, insofar as sales by the chain's subsidiary wholesaler were actually made at lower margins than those of competing wholesalers, one result, desirable at least in the short-run, would be to increase pressure on wholesalers' margins, generally. If the longer-run results of the control of wholesalers by chains (or by a common financial interest) were to promote concentration and oligopolistic behaviour in grocery

distribution, the consequences for grocery suppliers, for independent retailers and for consumers would likely be less favourable.[1]

Voluntary Chains

There is a second category of chain food store operation which is distinguished from the corporate chain to which the data quoted above apply - that is the category variously named "voluntary chain", "co-operative group", "organized group", and so on. Characteristic of this type of operation are such groups as the Red and White Stores, I.G.A. Stores, Tom-Boy Stores and Regal Stores Inc. To be precise, the operations of these "organized groups" fall into two classes. First, there is that category in which a wholesale supplier is associated with a number of independent retailers. Although the details of the relationship may vary somewhat from group to group, in general the retailers undertake certain responsibilities with respect to their purchasing and operating practices in return for merchandising assistance, buying advantages, and perhaps the provision of capital on the part of the wholesaler. The second category of "organized groups" comprises those which are made up of a number of affiliated retailers who pool their orders for merchandise in order to secure better buying terms; these are sometimes called "buying associations". These groups are not ordinarily connected with any one wholesaler, nor are their buying arrangements always on a permanent basis.

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1. For discussion of a related issue see the section quoted from Alfred Marshall, Industry and Trade, in Chapter II, pp. 51 to 52, of this statement.

Retail Merchandise Trade of Voluntary Chains and Buying Association Members

| | | Number of Stores | Average Sales Per Unit | Per Cent of Total Sales For Category |
|---|---|---|---|---|
| | | | $ | % |
| Grocery stores | - 1930 | 2,079 | 19,800 | 16.9 |
| | - 1941 | 1,423 | 21,100 | 11.3 |
| | - 1951 | 585 | 63,600 | 6.0 |
| Combination stores | - 1930 | 789 | 33,800 | 16.5 |
| | - 1941 | 656 | 38,800 | 8.4 |
| | - 1951 | 615 | 93,900 | 4.5 |

Source: Date for 1930 and 1941 from Census of Canada, 1941 Vol. X, Table 13; and for 1951 from Census of Canada, Vol. VII, Table 16.

It is clear from the accompanying table that voluntary group retailers in the grocery store category lost ground steadily between 1930 and 1951 both in terms of numbers of stores and of the percentage of sales for all grocery stores.[1] Combination stores belonging to voluntary chains or buying associations have shown only a moderate decline in numbers but in their share of total sales of combination stores they had up to 1951 experienced a very sharp reduction.

In addition to the food independents classified as members of voluntary chains shown in the above table, there are a number of retailers in the "country general store" category which belong to voluntary chains and carry some grocery products. In 1930 there were 1,524 such stores with sales of all products of $38,776,900, which accounted for 18.7 per cent of total sales by country general stores. In 1941, the number of such stores had declined to 1,359, and their sales had fallen slighdy to $37,318,000, which accounted for 17.4 per cent of sales for this category of store. In 1951, the basis of classification was changed from

1. No data is available from official sources for the years after 1951, but see below for some unofficial estimates.

"country general store" to "general stores (more than one-third foods)". In this new category there were 520 stores that belonged to voluntary chains or were members of buying associations, with sales of \$36, 982, 000, which accounted for 7.1 per cent of total sales for this category of store.

It is general knowledge that some of these voluntary chains have undergone a considerable change in their method of operation and have enjoyed a substantial increase in volume of sales within the past few years, but very little firm statistical information for the class as a whole is available. An estimate of their numbers and sales volume in 1956, appearing in The Canadian Grocer, February 2, 1957, may be of interest as providing an informed opinion as to the probable magnitudes involved.

> "There are approximately 4, 250 stores coast to coast operating as organized group members. Working from retail sales' estimates by head offices of some of the major groups, Canadian Grocers estimates that their total retail volume would approximate \$425, 000, 000 in 1956, or a little better than 25 per cent of total store sales.[1] This is an average of \$100, 000 per store. Some major groups would average considerably more than that, some groups of smaller stores would average less."

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1\. The figure of 25 per cent appears to be rather high since total food store sales amounted in 1955 to \$2, 429, 581, 000. In a later estimate published by Canadian Grocer, June 22, 1957, estimated sales for voluntary groups were set at \$554, 713, 000 for 1957, or 22 per cent of total food sales.

Some figures on sales of voluntary groups in the U.S.A. are given in a report in The Journal of Commerce, (New York) March 19, 1957, p. 15.

"Affiliated retailers belonging to voluntary merchandising groups such as I.G.A., Spartan, Foodtown, Super Valu, Red and White, and Clover Farm, plus those who belong to co-operative buying groups did 44 per cent of total U.S. grocery store sales in 1956, Mr. Mueller said, citing the findings of Progressive Grocer's annual industry survey.

This compared, he said, with 37 per cent of total sales by chain stores and 19 per cent by independents operating without the organized assistance of their wholesaler suppliers. . . ."

The editor included the following regional breakdown of the number of units in voluntary chains:

| | | |
|---|---|---|
| British Columbia | - | 455 |
| Prairies | - | 1, 298 |
| Ontario | - | 1, 257 |
| Quebec | - | 855 |
| Maritimes | - | 389 |
| Total | - | 4, 254 |

To provide a partial comparison with this over-all estimate, the following quotation, reported in Winnipeg and Western Grocer, January, 1957, from a statement by the general manager of I.G.A. in Canada, may be of assistance:

> "'In 1952, the organization made a modest beginning . . . with 69 stores. At the close of 1953, the first full year of operation, our sales totalled . . . $36, 000, 000. At the end of 1954, we had 307 stores doing a gross volume of $82, 000, 000. Sales during 1955 were $110, 000, 000 and today with approximately 600 stores in eight of the ten provinces, our sales have reached $149, 000, 000'."

Thus, with about 14 per cent of the estimated total number of units in organized groups, I.G.A. groups accounted in 1956 for about 35 per cent of estimated sales for such groups. Average unit sales were approximately $250, 000. To reach the Canadian Grocer estimate of total sales for voluntary chains, it would be necessary that the units outside the I.G.A. should have average annual sales of approximately $75, 000. This would not seem to be an implausibly high figure in view of the average unit sales for 1951 shown in the above table.[1]

Thus, it would appear that the corporate and voluntary chains together account for something in the neighbourhood of 60 per cent of total sales by grocery and combination stores, although, even allowing for a possible 10 per cent decline in the total number of retail units since the 1951 census, they would probably constitute

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1. Canadian Grocer's "Survey of Co-operative Groups", in the issue of June 22, 1957, would suggest that annual sales per unit of $75, 000 tends to be a minimum figure.

only about 18 per cent of the total number of retail food stores.

There are no average data on operating results covering sales by wholesalers to retailers in voluntary groups. It was, however, reported in the Director's survey of loss-leader selling[1] that the gross profit taken on sales to affiliated independents by a large grocery wholesaler in Vancouver ranged from 5 per cent on monthly sales of $2,500 or over, to 5-1/2 per cent on sales between $2,500 and $1,000, to 6 per cent on sales of less than $1,000. Another grocery wholesaler, in Fort William, selling to affiliated retailers had a "fee schedule" covering twelve volume categories, from a fee of 5.815 per cent on monthly purchases of $1,000 to $1,499, through a fee of 5 per cent on monthly purchases of $2,500 to $2,999, to the minimum fee of 3.75 per cent on monthly purchases of $6,500 and over. Canadian Grocer, June 22, 1957, reported that the "service-management" fee charged by the Independent Grocers' Alliance (I.G.A.) to affiliated retailers ranged from 3 per cent to 4.7 per cent on dry grocery purchases. This fee covered the retailer's share of warehouse overhead, buying, merchandising, store engineering and other expenses. In addition, a charge of 1/2 of 1 per cent of store sales was made for co-operative advertising. In the case of another affiliated group, reported in the same article, retailers bought groceries, tobaccos, health and beauty needs at cost plus 2 per cent, cash and carry. They also paid a weekly fee of $13 to cover store engineering service and various advertising and promotional services.[2]

The following data on retail trade by volume of sales of the individual store in 1951 will provide a general background against which to assess the significance of the amount of sales concentrated in corporate and voluntary chains.

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1. Material Collected by the Director of Investigation and Research in Connection with an Inquiry into Loss-Leader Selling (Department of Justice, Ottawa, 1954), p. 232.

2. The reader may find it of interest to compare these margins with the operating results of grocery wholesalers reported above at page 66.

Sales by Grocery and Combination Stores, With and Without Meat, 1951

| Size of Business | No. of Stores | % of Total | Sales $'000 | % of Total |
|---|---|---|---|---|
| 0 - $1,999 | 1,797 | 5.2 | 2,118.3 | 0.1 |
| $2,000 - $4,999 | 2,788 | 8.1 | 9,129.2 | 0.47 |
| $5,000 - $9,999 | 3,545 | 10.3 | 25,548.3 | 1.3 |
| $10,000 - $19,999 | 5,872 | 17.0 | 85,993.8 | 4.5 |
| $20,000 - $29,999 | 4,708 | 13.7 | 115,823.9 | 6.1 |
| $30,000 - $49,999 | 6,451 | 18.7 | 246,504.3 | 13.0 |
| $50,000 - $99,999 | 5,801 | 16.9 | 399,464.7 | 21.0 |
| $100,000 - $199,999 | 2,227 | 6.5 | 299,268.5 | 15.8 |
| $200,000 - $499,999 | 709 | 2.1 | 208,124.5 | 11.0 |
| $500,000 or over | 493 | 1.4 | 504,369.5 | 26.6 |

Source: Census of Canada, Vol. VII, Table 10.

With net profit in independent retail grocery stores averaging 4 to 5 per cent[1] (before deduction of proprietor's salary and income tax), and even making generous allowance for the fact that there is a substantial range of net profit above this average, it is obvious that a considerable number of these retail stores are not operated on a commercial basis. For example, sales of $20,000 at a net profit of five per cent would yield only $1,000 return to the proprietor before income tax. A return of this amount or less was earned in 1951 by 40.6 per cent of grocery and combination stores, but these accounted for only 6.37 per cent of total sales for such stores. If, on the same basis, we were to raise the proprietor's return to $1,500 or less, 54.3 per cent of all grocery and combination stores accounting for 12.47 of total sales would be included. At the other end of the frequency distribution, the open-end class covering sales of $500,000 and over" per unit includes only 1.4 per cent of the total units with 26.6 per cent of total sales. The concentration in this class is, in fact, even more marked than the 1.4 per cent of units would suggest. From data in Retail Chain Stores

1. In 1952, net profit for independent grocery stores was 5.2 per cent and for independent combination stores 4.1 per cent. Operating Results and Financial Structure, Retail Food Stores, 1952 (Independent), D.B.S. The profit figures for 1950 are the same as for 1952; no data is available for 1951.

(D.B.S.), it is apparent that roughly 450 grocery and combination chain units had sales of $500, 000 and over per unit in 1951, and, therefore, accounted for something in the neighbourhood of 90 per cent of the units in this size-class and about 95 per cent of sales. Hence, a comparatively few grocery chains having units with sales of $500, 000 and over accounted in 1951 for something in the neighbourhood of 25 per cent of total sales, a conclusion that is not surprising in view of the earlier computation that in 1955 the "Big Four" chains accounted for 27.8 per cent of total sales by all grocery and combination stores in Canada.

In the next smaller size-class which includes stores with annual sales of $200, 000 - $499, 999, the chains in 1951 accounted for just under 300 of the 709 units and about 45 per cent of total sales. In the $100, 000 to $199, 999 volume of sales class, chains had only about 12 per cent of the units with just under 13 per cent of sales. Only 2.3 per cent of sales by corporate chains are made through units with annual sales of less than $100, 000.

Operating Results - Independent Retail Food Stores

The following summary provides an indication of recent trends in average gross and net profits for independent food stores. The D.B.S. notes that "These ratios are the 'average' of a broad range of operational efficiency and as such do not represent top performance guides." This condition, which applies in greater or less degree to all averages, constitutes a warning as to the use to which the average is put rather than limiting its validity in reporting trends.

Average Gross and Net Profits

| Year | Grocery Gross Profit % | Grocery Net Profit % | Combination Gross Profit % | Combination Net Profit % |
|---|---|---|---|---|
| 1938 | 16.0 | 4.5 | 17.4 | 4.1 |
| 1941 | 15.2 | 5.7 | 16.9 | 5.2 |
| 1944 | 14.2 | 6.3 | 15.2 | 5.8 |
| 1945 | 14.1 | 6.1 | 14.9 | 5.0 |
| 1946 | 14.3 | 6.0 | 15.1 | 4.8 |
| 1948 | 14.0 | 5.7 | 14.6 | 4.4 |
| 1950 | 14.4 | 5.2 | 14.9 | 4.1 |
| 1952 | 13.8 | 5.2 | 14.6 | 4.1 |
| 1954 | 14.3 | 5.2 | 15.4 | 4.1 |

Source: D.B.S., Operating Results and Financial Structure Retail Food Stores 1954 (Independent), p. K-8.

Perhaps the most noteworthy features of this table are:

(1) Average gross profit in recent years is moderately below pre-war for both grocery and combination stores.

(2) Net profit for both categories of store has declined from post-war peaks but has stabilized during the period 1950-54 at the 1938 level in the case of combination stores (4.1 per cent) and about 15 per cent above the 1938 level in the case of grocery stores (5.2 per cent).

(3) The differential between the net profit for grocery independents and combination independents widened from 0.4 per cent in 1938 to 1.1 per cent in 1954.

Detailed information is also available for grocery stores and combination stores separately on operating results by sales-size categories. The number of stores in each category does not necessarily represent accurately the significance of that sales-size in total trade. Indeed, the D.B.S. warns that "The response from large stores is generally better than that from smaller ones." In order to correct for this shortcoming in the returns, census weights were applied to the various expense and profit ratios of the

different sales-size classes to obtain ratios for whole groups (such as the totals reported above).

The two tables that follow, reporting the unweighted data as shown by the D.B.S., are largely self-explanatory and the reader will be able to follow the changes in operating results for the different size-classes without detailed comment.

In the "independent grocery stores" group, the only increases in net operating profit for "owned stores" were shown by the two largest sales-size classes, and for "rented stores" by the largest sales-size class and the "$10, 000 to $19, 999" sales class. All size-classes reported increases in their "operating expenses" percentage with only two exceptions - the largest sales-size class in "owned" and "rented" stores, both of which reported decreases.

In the "independent combination stores" group, only a single sales-size class reported an increase in net operating profit in either "owned" or "rented" stores - the "$10, 000 to $19, 999" sales class of "owned" stores. Stores of this size are of minor significance in grocery distribution. All size-classes reported increases in their "operating expenses" percentage, again with two exceptions - the "$10, 000 to $19, 999" sales class of "owned" stores and the "$20, 000 to $49, 999" sales class of "rented" stores, both of which reported decreases.

## INDEPENDENT GROCERY STORES

| | | Owned stores with annual net sales of | | | | | Rented stores with annual net sales of | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Under $10,000 | $10,000 to $19,999 | $20,000 to $49,999 | $50,000 to $99,999 | $100,000 and over | Under $10,000 | $10,000 to $19,999 | $20,000 to $49,999 | $50,000 to $99,999 | $100,000 and over |
| No. of stores reporting | - 1946 | 92 | 204 | 327 | 79 | 19 | 46 | 128 | 342 | 144 | 31 |
| | - 1954 | 30 | 77 | 182 | 105 | 25 | -[1] | 33 | 112 | 99 | 36 |
| Gross profit[2] | - 1946 | 16.5 | 13.9 | 13.4 | 13.7 | 13.8 | 17.4 | 15.0 | 14.7 | 15.0 | 14.5 |
| | - 1954 | 18.10 | 14.55 | 13.79 | 14.20 | 13.54 | - | 17.68 | 14.27 | 14.51 | 14.83 |
| Total operating expenses | - 1946 | 7.2 | 6.3 | 7.2 | 8.7 | 9.7 | 8.3 | 7.2 | 7.9 | 9.5 | 10.5 |
| | - 1954 | 10.06 | 7.72 | 7.83 | 8.96 | 9.33 | - | 9.56 | 8.70 | 9.83 | 10.10 |
| Net operating profit[3] | - 1946 | 9.3 | 7.6 | 6.2 | 5.0 | 4.1 | 9.1 | 7.8 | 6.8 | 5.5 | 4.0 |
| | - 1954 | 8.04 | 6.83 | 5.96 | 5.24 | 4.21 | - | 8.12 | 5.57 | 4.68 | 4.73 |

1. Data for this size-class not reported in 1954.
2. Profit and other operating data computed as a per cent of net sales.
3. Net operating profit before deduction of proprietors' salaries and income tax.

Source: D. B. S., Operating Results and Financial Structure Retail Food Stores.

INDEPENDENT COMBINATION STORES

| | | Owned stores with annual net sales of | | | | | Rented stores with annual net sales of | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | | Under $10,000 | $10,000 to $19,999 | $20,000 to $49,999 | $50,000 to $99,999 | $100,000 and over | Under $10,000 | $10,000 to $19,999 | $20,000 to $49,999 | $50,000 to $99,999 | $100,000 and over |
| No. of stores reporting | - 1946 | 17 | 69 | 183 | 133 | 69 | -[1] | 20 | 151 | 158 | 77 |
| | - 1954 | -[1] | 37 | 130 | 146 | 126 | -[1] | 8 | 72 | 111 | 123 |
| Gross profit[2] | - 1946 | 19.0 | 15.5 | 14.3 | 15.0 | 14.5 | - | 15.6 | 16.1 | 15.6 | 15.4 |
| | - 1954 | - | 15.81 | 14.39 | 14.68 | 14.85 | - | 19.02 | 15.67 | 15.50 | 15.66 |
| Total operating expenses | - 1946 | 10.5 | 8.0 | 8.6 | 10.0 | 10.7 | - | 7.2 | 10.3 | 10.7 | 11.3 |
| | - 1954 | - | 7.58 | 8.73 | 10.19 | 11.39 | - | 13.98 | 10.07 | 11.19 | 12.05 |
| Net operating profit[3] | - 1946 | 8.5 | 7.5 | 5.7 | 5.0 | 3.8 | - | 8.4 | 5.8 | 4.9 | 4.1 |
| | - 1954 | - | 8.23 | 5.66 | 4.49 | 3.46 | - | 5.04 | 5.60 | 4.31 | 3.61 |

1. Data for this size-class not reported.
2. Profit and other operating data computed as a per cent of net sales.
3. Net operating profit before deduction of proprietors' salaries and income tax.

Source: D. B. S., Operating Results and Financial Structure Retail Food Stores.

Operating Results - Chain Food Stores

The review of the operating results of chain food stores will be limited to chain combination stores since chain grocery stores no longer account for any substantial proportion of sales. In 1951, for example, chain grocery stores had sales of about $44, 000, 000 against sales of approximately $566, 000, 000 for chain combination stores.

Chain Combination Stores[1]

| | Gross Profit % | Total Expenses % | Net Operating[3] Profit % | Total Net[2] Profit Before Income Tax % |
|---|---|---|---|---|
| 1947 | 15.99 | 13.23 | 2.76 | - |
| 1949 | 15.60 | 13.13 | 2.47 | 2.83 |
| 1951 | 15.82 | 12.67 | 3.15 | 3.34 |
| 1953 | 16.50 | 13.26 | 3.24 | 3.52 |
| 1955 | 16.45 | 13.40 | 3.05 | 3.21 |

1. All figures expressed as percentage of net sales.

2. After addition of non-trading income and deduction of non-trading expense.

3. Before income tax.

Data on operating results for food chains were first compiled in 1947. Sales of chain grocery and combination stores in that year amounted to about $302, 000, 000 and by 1955 they had increased to about $963, 000, 000, with an almost unchanged number of stores. The operating ratios for chain combination stores as a whole indicate that the gross profit percentage in 1949 fell off slightly from the 1947 level and then increased to its peak value in 1953 and remained almost unchanged in 1955.

The total operating expenses percentage declined from 1949 through 1951 and then increased, reaching its peak in 1955. The net operating profit percentage was lower in 1949 than in 1947, increased through 1953 and then fell off moderately in 1955.

Operating Results of Chain Combination Stores
by Size of Firm (D.B.S.)

| | | Under $1, 000, 000 | $1, 000, 000* to $9, 999, 999 | $10, 000, 000 and over |
|---|---|---|---|---|
| Number of Firms | - 1947 | 11 | 7 | 6 |
| | - 1951 | 5 | 10 | 6 |
| | - 1955 | - ** | 10 | 9 |
| Number of Stores | - 1947 | 55 | 86 | 691 |
| | - 1951 | 24 | 92 | 715 |
| | - 1955 | - | 108 | 879 |
| Gross Profit | - 1947 | 16.20 | 15.87 | 15.99 |
| | - 1951 | 15.82 | 14.94 | 15.88 |
| | - 1955 | - | 15.01 | 16.49 |
| Total Operating Expenses | - 1947 | 15.00 | 13.90 | 13.15 |
| | - 1951 | 15.54 | 13.62 | 12.60 |
| | - 1955 | - | 13.67 | 13.38 |
| Net Operating Profit before Income Tax | - 1947 | 1.20 | 1.97 | 2.84 |
| | - 1951 | 0.28 | 1.32 | 3.28 |
| | - 1955 | - | 1.34 | 3.11 |

* For 1947, this size class is shown as"$1, 000, 000 to $4, 000, 000" but the third size class is shown as "$10, 000, 000 and over".

** In 1955, there were too few respondents in the "Under $1, 000, 000" group to permit publication of results.

It is difficult to evaluate the significance of the data in the accompanying table relating to combination chains with sales of "under $1, 000, 000". It is clear that their operating results worsened seriously from 1947 to 1951: the gross profit percentage declined over this four-year period, although not to the same extent as for the chains in the next larger size-class; the operating expenses percentage increased, however, and this was in sharp contrast to the experience of both the larger size-classes which achieved some reduction in this factor. As a result, in 1951 net

operating profit before income tax for the smallest size-class of combination chains dropped very close to zero. Whether it was this apparent worsening in their condition that accounted for the decline in their numbers from 11 reporting chains in 1947 to five reporting chains in 1951, or whether the more successful chains in this size class moved into the next larger size-class (where the number of chains increased from 7 in 1947 to 10 in 1951), or whether some of them were absorbed by their larger competitors, it is impossible to say. It is probably pure coincidence that the number of stores in the chains reporting in the smallest size-class decreased by 31 between 1947 and 1951 and over the same years the number of stores in the chains reporting in the two larger size-classes increased by 30.

The major points of interest in the record of the operating ratios for the two larger size-classes of combination chains set out in the above table are:

(1) From 1947 to 1955 the "$1, 000, 000 to $9, 999, 999" size-class experienced a decline in its gross profit percentage of almost one percentage point, whilst during the same period the largest size-class, although beginning with approximately the same percentage figure as the chains in the middle size-class, experienced an increase of one-half percentage point. Thus, in 1955, its gross profit percentage was approximately one and one-half percentage points higher than that for the middle size-class.

(2) Over the same period the middle size-class effected a modest reduction in its operating expenses percentage and the largest size-class experienced a slight increase in its percentage. However, the middle size-class started the period at a higher level so that in 1955 its operating expenses percentage was still about three-tenths of a percentage point above that for the largest size-class.

(3) As a result of these changes, the middle size-class experienced a sharp decline in its net operating profit percentage - a decline of almost one-third, and the largest size-class displayed a modest increase in its percentage, to leave it in 1955 about 2.3 times the percentage of the middle size-class of combination chains.

The operating expenses of the food chains include head office and warehouse expenses as well as store expenses. The break-down, as supplied to D.B.S. by the chains, was to a large extent, arbitrary.

Operating Expenses of Combination Chains (D.B.S.)

(Size range over $10, 000, 000)

| | Head Office and Warehouse | Stores | Total |
|---|---|---|---|
| 1947 | 3.97% | 9.18 | 13.15 |
| 1949 | 3.39 | 9.63 | 13.02 |

For example, part, perhaps a substantial part, of head office expenditures is related directly to the retail division of the chain's operations, although no charge for executives' salaries was made to store expenses. Indeed, growing uncertainty among the chains compiling the data on operating expenses as to the proper allocation of expenses was apparently a major factor in discontinuing the publication of the information.

The data reported in the accompanying table suggest that head office and warehouse operating expenses accounted for about 24 to 30 per cent of total chain expenses. It is of interest to compare these head office and warehouse expenses percentages with related figures - which are, however, limited to warehouse expenses - obtained by the Director of Investigation and Research in connection with the survey of loss-leader selling. It was reported in that survey that a chain in Winnipeg, Manitoba, in 1953 applied a "warehouse charge" of 2 per cent to all merchandise supplied to its chain stores. Although this charge was subject to later adjustment should costs exceed it, no adjustment had been required from January 1, 1953 to the date the information was reported to the Director (April 23, 1953).[1]

A chain in Vancouver reported, in the same inquiry, that its "warehouse upcharge" fluctuated as follows during the early part of 1953:

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1. Material Collected by the Director of Investigation and Research in Connection with an Inquiry into Loss-Leader Selling, (Department of Justice, Ottawa, 1954) p. 218.

Four Weeks Ending -

January 24, 1953 - 2.34%
February 21, 1953 - 2.03%
March 21, 1953 - 2.09%[1]

It has also been recently reported to the Director that with the geographic spread of chains to smaller communities, a significant and increasing proportion of merchandise to supply the outlying chain units is coming, not from the central warehouse of the chain, but from wholesalers more conveniently located to such units. Should such arrangements become widespread they could exert an influence on the distribution of chain operating expenses between the central warehouse and retail stores, and probably on the level of operating expenses as well.

## Size of Business and Average Sales Per Person Engaged

The wealth of information in Volume VII (dealing with retail trade) of the Census of Canada, 1951, does not provide any measures of the relationship between size of business and sales per person engaged, nor are the data reported in such a way as to make such computations possible. Through the co-operation of the Dominion Bureau of Statistics, the material in Table 16 for "grocery stores, without fresh meat"; "grocery stores, without fresh meat, with beer"; "combination stores"; "combination stores with beer", was re-classified and stores were grouped according to the minimum number of employees per store. That is, stores were classified into ten groups according to whether they employed, at the minimum, no employees, one employee, two, three, four, five to nine, ten to nineteen, twenty to forty-nine, fifty to ninety-nine, or one hundred and over employees . Data were provided on the number of stores in each group, total sales for the stores in the group, and minimum

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1. Ibid., p. 232. This chain is a division, as is the chain referred to in the preceding paragraph, of the chain-wholesale organization to which the data on gross and net profit and on "expenses" on sales to the parent chain and to independents, reported on p. 73, apply. Assuming that the data are compiled on comparable bases, it appears that a substantial reduction in the "expenses" percentage on sales to the parent chain was achieved between 1947 (the year to which the data on p. 73 apply) and 1953.

and maximum number of employees for the stores in each group. The same information was provided in a separate tabulation for multi-unit and chain stores[1], which were, of course, included in the totals.

In order to determine the number of persons engaged by size of business, it is necessary to add the number of working proprietors to the number of employees. Precise data on the former are not apparently available on the basis of classification used in the present tabulation. A fairly close approximation to the number of working proprietors can be made by assuming that there will be one working proprietor to each "independent" store. The number derived on this basis falls somewhat short of equalling the total number of working proprietors in the grocery trade. It seems probable that these additional numbers would tend to be concentrated in the size group having "no employees", since it is not uncommon for the wife of the working proprietor to assist at rush hours in such small units. No adjustment in the data has, however, been made on this basis, and this deficiency in the completeness of coverage should be kept in mind when reading the average sales figures.

Sales per person engaged, subject to the above qualification, is the only suitable measure of efficiency which can be calculated from the census data. The limitations of using numbers of persons engaged as a basis for measures of efficiency have been frequently discussed; however, they are of less significance here than in some other industries. There are, nonetheless, some difficulties about the use of this, or any other, measure of efficiency in grocery distribution which should be referred to. Although all grocery stores are engaged in the same general type of business, they do not all perform the same functions. Some of the smaller stores provide telephone and delivery service and "charge" accounts, whilst the stores of the larger chains rarely do so. When the latter supply delivery service they may have an arrangement with an outside firm to perform the service at an added charge to those customers who wish to use it. The employees involved would not, in such cases, be shown as chain-store employees. Many of the smaller grocery stores are located in small towns with the result that geographical market imperfections place limitations on their size. Such factors as these make it difficult to compare like with like in this field of distribution and suggest that only substantial

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1. Chain stores are organizations operating four or more retail stores in similar or related kinds of business under the same ownership; multi-unit stores are those with two or three retail stores under the same ownership.

and consistent trends should be considered significant.

Table 3-1 shows average sales per person engaged for all stores [1], for multi-unit and chain stores, and for "independents" (i.e., "all stores" minus "multi-unit and chain stores"). Few firm conclusions can be drawn from the statistics. Multi-unit and chain stores have substantially higher sales per person engaged than "independents". This condition holds, with considerable variation in the differential, from the second size class through the eighth. The average for the ninth size class for "independents"(50-99 employees), although almost identical with that for multi-unit and chain stores, is based on data for only two stores and hence is of limited significance. How far the differential is accounted for by differences in the nature and extent of the services provided by the two categories of store it is impossible to say.

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1. The averages are based on the maximum number of persons engaged in the various size-classes. In view of the very large proportion of grocery-store sales made in the last two days of the week when numbers employed are likely to reach their peak, it was considered that figures for maximum numbers would be of greater significance than those for minimum numbers, although an exhaustive analysis would probably include both.

TABLE 3-1

FOUR GROCERY TRADES BY NUMBER OF EMPLOYEES FOR CANADA, 1951

(Stores grouped according to minimum number of employees)

| Number of Employees | Total Stores (No.) | No. of Multi-Unit and Chain Stores | Total Sales - All Stores $000 | Sales - Multi-Unit and Chain Stores $000 | Average Sales Based on Max. No. Engaged - All Stores $ | Average Sales Based on Max. No. Engaged - Multi-Unit and Chains $ | Average Sales Based on Max. No. Engaged - "Independents" $ |
|---|---|---|---|---|---|---|---|
| 0 | 17,059 | 42 | 270,320.7 | 753.0 | 15,355.64 | 16,369.56 | 15,352.98 |
| 1 | 8,189 | 123 | 300,077.7 | 4,488.5 | 16,204.64 | 25,648.57 | 16,114.55 |
| 2 | 3,589 | 138 | 200,907.0 | 8,156.3 | 16,415.31 | 22,910.95 | 16,220.71 |
| 3 | 2,029 | 192 | 161,951.6 | 18,409.7 | 17,632.18 | 24,744.22 | 17,005.31 |
| 4 | 1,071 | 140 | 109,122.7 | 18,112.8 | 17,947.81 | 23,990.46 | 17,091.06 |
| 5-9 | 1,647 | 419 | 282,379.3 | 106,330.2 | 21,136.17 | 30,847.17 | 17,759.41 |
| 10-19 | 469 | 283 | 205,364.7 | 153,589.2 | 25,985.66 | 30,878.40 | 17,676.85 |
| 20-49 | 268 | 234 | 251,882.0 | 235,673.2 | 25,470.92 | 26,626.73 | 15,615.41 |
| 50-99 | 67 | 65 | 114,868.5 | 111,577.9 | 22,786.84 | 22,784.94 | 22,851.38 |
| 100 + | 2 | - | 2,021.7 | - | 8,530.37 | - | 8,530.37 |

Within the category of "multi-unit and chain stores", economies associated with increasing numbers of employees would appear not to be significant except for two size categories: 5-9 employees, and 10-19 employees. Within the category of "independent", there is nothing to suggest any significant increase in volume of sales per person engaged as the number of employees increases. The qualification noted above with respect to the number of working proprietors may affect the averages in some measure, particularly those for the smaller size classes, but even making substantial allowance for this factor, it appears unlikely that any marked and consistent trend would emerge.[1]

Summary

In view of the nature of the material in this chapter, there would be little advantage in undertaking a detailed summary of even the major points covered; however, there are four broad features of the data that may be worth recalling to mind.

First, it is apparent that operating margins in the grocery trade are quite narrow. This is notably the case in the wholesale trade. Buying differentials as between different trade categories amounting to substantially less than one percentage point would be sufficiently large to have a strategic bearing on the success, or even the survival of distributors.

Second, grocery wholesalers over the years 1947 through 1955[2] experienced very marked changes in their operating results. Wholesalers were the only group of the three major categories of grocery distributors (wholesalers, independent retailers and chain stores) to achieve a reduction in their gross profit figure during the period under review. Independent grocery stores had the same percentage figure in 1954 as in 1946; independent combination stores showed a slight increase over the same period; and chain combination stores also had a slight increase over the years 1947-1955. All three major categories showed varying increases in operating expenses.

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1. Chains, corporate and voluntary, may, of course, achieve economies of scale in such matters as general administration, advertising, lower inventory costs, integrating the wholesale and retail functions, spreading risk over a larger number of units, obtaining capital, and the like.

2. At the time of writing, data were not available for the period after 1955.

As a result, the rate of net operating profit fell very sharply for wholesalers and moderately for independents, but actually increased for combination chains as a group.

Third, chain stores gained a large increase in their share of total sales from 1951 to 1955, rising from 29.6 per cent in the former year to an estimated figure of 39.6 per cent in 1955.

Fourth, voluntary chains, after apparently losing ground steadily from 1930 to 1951, made a conspicuous recovery, and in 1956-57 were estimated to account for something in the neighbourhood of 20 to 22 per cent of total sales.

CHAPTER IV

# REVIEW OF DISCOUNT STRUCTURES

The information which forms the basis of this review of discount structures was obtained by means of a questionnaire, Schedule I-G, which is attached to this section as Annex I, sent to 78 of the largest manufacturers of grocery products in Canada which were selected for the Director by major grocery distributors. A letter accompanying the questionnaire (also included in Annex I) indicated that this survey was prompted largely by "a considerable number of representations to the effect that the competitive position of certain classes of dealers, and particularly smaller independent dealers, is being unfairly prejudiced by the prices at which they must buy compared with their larger competitors."

Returns were received from 72 manufacturers and, of these, 68 provided sufficient detail to be included within the classifications described below. Of these 68 firms, approximately 15 reported that they gave no discounts whatever and gave no preference to any class or group of buyers. The majority of these manufacturers sold only to large buyers. Since, with only one exception, all of these 15 firms published their prices on a delivered basis, some discrimination might be said to exist between buyers in different areas, but no differentiation of prices by size of order, or otherwise, was used.

The remaining 53 firms employed one or more systems which created price differences among customers. These systems were based on the trade classification of the customer (including such demarcations as "volume" and "regular" customers as well as the more usual functional delineations), on the quantity of goods purchased at one time, on the volume of goods taken over a period, and in a few instances on criteria which defy rigorous classification. In most instances a system was based on a combination of one or more of the preceding criteria.

The first three categories referred to above are termed, "trade discounts", "quantity discounts" and "cumulative discounts" respectively, in the following analysis. Criteria which could not be classified include instances in which a special discount was extended to individual buyers which for no stated reason was not extended to others.

## Trade Discounts

The most common distinction made by manufacturers among classes of customers for price purposes is that between wholesaler and retailer. Frequently one price list is issued, from which the wholesaler receives a discount; the retailer may receive a lesser discount or purchase at list. Alternatively, separate list prices may be issued, the prices shown on the wholesaler list being lower than those shown on the retailer list. Since the systems are similar in effect, both types of price differentiation are referred to here as "trade discounts". Large retailing organizations such as chain groceries, which have central warehouses and actually perform their own wholesaling functions for most items are frequently treated as wholesalers. In some cases, however, manufacturers established distinct trade classifications for such accounts or grouped them with other types of retailer. As many as seven trade classes were recognized by some manufacturers from whom returns were received.

## Quantity Discounts

Whilst many manufacturers did not ordinarily do business directly with very small purchasers, a number were prepared to deliver any quantity from single cases to carlots. Usually, where the quantity to be delivered was subject to wide variation, unit prices varied according to the quantity purchased at one time. The quantity was expressed in dollar value, in number of units purchased or in total weight of shipment, and price differentials were expressed either in percentage differentials or in absolute figures set out on a columnar basis. Two of these methods are illustrated by the following examples from the returns:

(i)

| | |
|---|---|
| Less than 5 cases | - List |
| 5-9 cases | - List less 1% |
| 10-24 cases | - List less 2% |
| 25-49 cases | - List less 3% |
| 50-99 cases | - List less 4% |
| 100 cases and up | - List less 5% |

(ii)

| | | Total Weight of Shipment | | |
|---|---|---|---|---|
| Item | Less than 100 lbs. | 100-499 lbs. | 500 lbs to Carload | Carload |
| "A" | 2.00 | 1.96 | 1.92 | 1.88 per case |
| "B" | 5.55 | 5.45 | 5.35 | 5.25 per case |

Quantity discount systems were frequently used in combination with trade discounts, and in some cases with cumulative discounts.

Cumulative Discounts

Allowances made on the basis of the quantity of goods purchased over a period of time are referred to here as "cumulative discounts". Such discounts are also referred to by some writers as "volume discounts". The period in question commonly ranges from a week to a year. Usually the manufacturer sets out a series of volume brackets, and the discount applying to total sales falling within each bracket. In a few cases the discount was dependent on an increase in purchases over those in a previous period. The allowances may be paid to a buyer as a lump sum rebate at the end of the period to which it applies, or interim allowances may be made, subject to adjustment at the end of the period. In other cases the total amount purchased during one year determined the allowance made at time of sale during the succeeding year.

In a number of instances "advertising allowances" fitted the above definition of cumulative discounts in that the amount of the rebate paid was determined by volume of purchases over a period. While in most of these cases some minimum of advertising performance was required of the recipient, there was no direct relationship between the cost or extent of such advertising and the rebate paid. When such allowances are shown on the face of the invoice they will be considered as cumulative discounts; when they do not, as is more frequently the case, they will be included in the later analysis of special discounts and allowances.

Cumulative discoungs may be related to either unit or dollar volume, as illustrated by the following examples taken from the returns:

(i)

| Annual Volume | Discount |
|---|---|
| Less than 2, 000 units | None |
| 2, 000 to 4, 999 " | 1% |
| 5, 000 to 9, 999 " | 2% |
| 10, 000 to 14, 999 " | 3% |
| 15, 000 to 24, 999 " | 4% |
| 25, 000 units and over | 5% |

(ii)

| Monthly Volume | Discount |
|---|---|
| Less than $200.00 | None |
| $200.00 - $499.00 | 2-1/2% |
| $500.00 - $999.00 | 5% |
| $1, 000 and up | 7-1/2% |

Basis of Classifying Discount Structures

There is perhaps no entirely logical or satisfactory basis for classifying the variety of discount structures reported in the present survey. Different types of discounts are combined in numerous patterns to build up structures that do not lend themselves to precise classification. However, to some degree these structures appear to be influenced by the type of distributive organization through which the goods of the manufacturer reach the public and the extent to which manufacturers undertake distribution of their own products.

For instance, some manufacturers of grocery products sell directly only to wholesalers and such retail organizations as are able to take delivery on a wholesale scale. Corporate chains are ordinarily included in the latter group. Other manufacturers, while selling to some extent through wholesale channels, sell also to all classes of retail grocers, with or without a stipulation as to minimum order. As might be expected, manufacturers who sell only to large buyers tend to employ less extensive and less complex systems of price "differentiation" than those whose direct accounts include, in addition, small retailers. Hence, to provide some general basis of classification, discount structures have been divided into three categories: (1) firms selling to large buyers only; (2) firms selling to all classes of dealer, with minimum shipment qualifications; (3) firms selling to all classes of dealer, with no minimum shipment qualification.

1. Firms Selling to Large Buyers Only

Slightly less than one-third of the manufacturers of grocery products from whom returns were received did not ordinarily make direct sales to single-outlet retail grocers. Manufacturers of goods having transportation costs relatively high in proportion to value of product, tend to be concentrated in this group. Categories of buyers recognized by these manufacturers included, in all but one case, corporate chain groceries in addition to wholesalers, and a number of firms indicated that supermarkets, department stores and affiliated groups of independent retailers were recognized as direct customers. Generally, warehousing or other arrangements for handling volume shipments would be necessary to dealers purchasing from manufacturers in this group. The volume taken by individual buyers, nevertheless, appeared to be subject to rather wide variation. Quantity brackets in respect of cumulative discounts, for example, provided for purchases ranging in one case from 1,500 to 22,500 cases annually, and in another from $10,000.00 to $500,000.00 annually.

Application of trade discounts in the price structures of these manufacturers was quite limited, and formed part of the price structure only where conditions peculiar to the field of manufacture had led to distinct differences in the functions of the various classes of distributor recognized.

In one instance, however, in which the manufacturer distinguished between chains, distributors, and jobbers, on the basis of trade discounts, a substantial trade discount was granted to an individual jobber which was not given to other jobbers or to the other categories of buyer. This one jobber received a 15 per cent discount off list price while other buyers, including other jobbers, received a 10 per cent discount. No explanation was given for this distinction and the jobber to whom this special discount was granted was not included in the list of the five largest purchasers of one product manufactured by the supplier, although he was listed as the fifth largest buyer of another product on which the manufacturer reported.

Quantity discounts were allowed by less than half of the manufacturers in this group. In all but one case, they appeared to be closely related to freight savings attaching to the quantities in question, and in the majority of cases were available only on carload lots. Such discounts did not in any case exceed two per cent of list. The exception referred to above allowed a discount which did not appear to relate primarily to freight savings. This was a discount of five per cent on 25 case lots, applying only to one item in the manufacturer's schedule.

While cumulative discounts were used by fewer manufacturers in the group than quantity discounts, the potential spread in net prices made possible by the former was usually greater, in some cases reaching five percentage points in maximum brackets. In two instances, cumulative discounts were available in addition to quantity discounts; a buyer whose purchases qualified him for maximum cumulative discounts would presumably take advantage also of carload discounts, and combined maximum allowances in these cases reached approximately six per cent.

While in most cases the greatest discount was available only to buyers in the highest purchase volume bracket, one manufacturer placed his customers on equal footing, regardless of size. This was done by allowing a basic discount only if the customer's purchases in one year equalled those in the previous year, and granting further discounts on specified percentage increments.

With minor exceptions, the same range of cumulative discounts was available to all customers recognized, the size of the discount depending only on volume purchased. In one case, the highest cumulative discount available to chains was slightly larger than that available to wholesalers, but also applied to substantially larger quantities; it is possible that in this case wholesalers' purchases had never approached the quantities taken by the largest chain buyer.

Another supplier granted cumulative discounts to chains which were 2 - 2 1/2 percentage points higher than those extended to wholesalers in the higher volume brackets.

In one instance, a special discount above that determined by the "volume-discount" schedule was granted to a particular chain. This "special" cumulative discount was apparently made available to the one buyer to "meet competition" in his area.

In still another instance the supplier granted a cumulative or volume discount of 2 per cent on all of its products to only one buyer while to other buyers it extended a cumulative discount on only one of its products. In explaining this situation the supplier reported that, "There are no special circumstances related to the general discount of 2% which is granted to ["X"]. Purchases by ["X"] of our products . . . amount to approximately 300% of the next largest purchaser of our products. . . ."

2. Firms Selling to All Classes of Dealer, With Minimum Shipment Qualifications

The manufacturers in this group did not base selection of direct customers on the trade classification of the latter, but either refused orders for less than a given quantity, or prepaid delivery costs only when a specified minimum was ordered. Since most retailers would probably find it more advantageous to buy from wholesale than to absorb the added cost of transportation, it is considered that, for practical purposes, the stipulation as to minimum order for prepayment of freight would have substantially the same force as a stipulation as to a minimum acceptable order.

Minimum quantities varied fairly widely, and in a few cases would not appear to be a serious deterrent to direct buying by the average grocer. In the majority of cases, however, it seemed unlikely that the smaller independent merchants would find it practical to take delivery in the minimum quantities unless they were participants in co-operative buying schemes or similar

arrangements. For example, one manufacturer required a minimum purchase of ten cases of one product, and another a minimum purchase of 25 cases. Some manufacturers in the group, however, offered pool car shipments, billed through wholesale, which appeared to extend considerably the number of retailers to whom the advantages of direct buying were available.

The majority of the manufacturers in this group - and particularly those whose minimum shipment stipulations were such that it appeared practical for individual retailers to place direct orders - distinguished between trade classifications for pricing purposes. Usually, in these cases, the price structure included a quantity discount feature through which the effect of trade discounts could be eliminated or substantially reduced, as is illustrated by the following example:

Price Schedule, Manufacturer "A"

| | Per case |
|---|---|
| To retail - 100-199 lbs. (minimum) | $8.00 |
| To retail - 200-299 lbs. . . . . . . . | $7.80 |
| To retail - 300 lbs. and up . . . . . . | $7.60 |
| To wholesale and chain . . . . . . . . . | $7.60 |

Ordinarily, chain stores were granted the same prices as grocery wholesalers, or could get such prices by taking delivery in sufficient quantity. In a few cases, however, wholesalers received slightly better prices than those available to any other class of buyer. On the other hand, chain stores sometimes received allowances in connection with advertising services which were not available to wholesalers, as in the following:

| | |
|---|---|
| Wholesale | - list less 12% |
| Chain | - list less 8% plus 5-1/2% advertising allowance. |

In this example the additional rebate was paid chains upon evidence that advertising or special promotion had been given the manufacturer's product. There was no indication that advertising amounting in cost to five and one-half per cent of purchases was necessary for payment of the full rebate.

Applying this analysis to the returns of all 68 manufacturers included in this survey a few more observations can be made. Approximately seven manufacturers extended better prices to wholesalers than to chain stores and other retailers. In three of these instances chain stores were granted an advertising allowance on a similar basis to that described in the example above, although it must be noted that even here the chain had to incur some advertising expenditures, while the price discount to wholesalers involved no such obligation. In the four other instances, the wholesaler's price advantage was not offset by exclusive advertising allowances to retail chains, although in three of these four cases the wholesaler's advantage was not substantial and extended only to one or two wholesalers and a narrow range of products. In at least five other cases chains were granted advertising allowances while receiving the same prices as wholesalers, and in three other instances chains were given prices below those received by wholesalers.

In the remaining cases, however, and therefore in general wholesalers and chains received the same prices.

In an application of trade discounts which was unique among the returns received, one manufacturer extended to variety chains and wholesale drug outlets lower prices on certain items than those available to grocery wholesalers and grocery chains. It was stated in part that such additional margins were necessary to the handling of the lines in question by the former types of outlets, where mark-ups were usually higher than in the grocery field.

Quantity discounts appeared to be more important in the price structures of manufacturers in this group than in those of manufacturers who sold only to customers purchasing on a wholesale scale. Minimum quantities on which such discounts were available were, in most cases, substantially below carload, and it appeared that they would be of considerable interest to grocery buyers of intermediate size.

Cumulative discounts were used in relatively few cases by manufacturers in the group, and ranged in maximum brackets from two per cent to five per cent. In all cases they were available to both wholesale and retail accounts, although not necessarily on the same basis. Where such discounts carried with them an understanding that some advertising or other promotional services would be furnished by the recipient, these allowances appeared to be available to retailers on somewhat more favourable terms than to wholesalers. In one case, dealers could obtain the maximum cumulative discount by taking minimum deliveries about once a month

and, in another, the minimum discount depended upon a percentage increase in purchases over those in the previous year so that the smaller direct buyers would not be at a disadvantage with respect to it. In the latter case, however, it appeared that only the larger direct buyers could, in practice, qualify for the higher cumulative discounts, and in the three remaining cases, it did not seem likely that the smaller direct buyers could qualify even for minimum cumulative discounts.

3. Firms Selling to All Classes of Dealer, With No Minimum Shipment Qualification

Most of the manufacturers who dealt directly with independent retailers as well as other classes of dealer, and who imposed no minimum shipment stipulations, sold goods which could not be warehoused for long periods, such as biscuits, tea and coffee, salad dressings and meat products.

All but two firms in the group employed trade discount systems. Those who did not, priced their goods on an f.o.b. factory basis, and in these two cases it seems probable that transportation costs attaching to small quantities would make it more advantageous for the small buyer to procure his supplies from wholesalers.

Trade discount structures described by a number of these manufacturers were quite complex. One manufacturer, for example, recognized the following trade classes:

(1) Independent retail.
(2) Independent group buyers.
(3) Independent retail normally buying in 20-unit lots.
(4) Co-operative buyers.
(5) Independent supermarkets.
(6) Corporate chains.
(7) Wholesalers and jobbers.

Whilst classes (2) and (3) received the same discount, as did classes (4) and (5), the discount available to class (6) varied according to conditions of sale and delivery so that, in all, seven different discounts were employed. The spread between the lowest and the highest discount granted was about fourteen per cent of list. The largest discount extended to chain stores was greater than that available to wholesalers by more than six per cent of list. In this case it was stated that the additional allowance to chains (which was

unavailable to other categories of buyer) covered part of the latter's advertising and display costs, and it was noted that no further advertising allowance was available.

The trade discount structure described above was unusual among those examined, both in the size of the price spreads which it created and in the advantages available to chain grocers. Prices available to grocery chains were found to be lower than those available to wholesalers in only two other cases, and in these by approximately one per cent of list. One firm, however, extended to variety chains a five per cent discount on some items which was not available to any other category and on certain other goods offered variety chains display allowances which were not extended to other classes of buyer.

Several manufacturers offered wholesalers prices below those available to chain grocers under any circumstances, and in a number of cases chains were granted wholesale prices only if they satisfied stipulated volume requirements. The most common practice, however, was the treatment of chains in the same manner as wholesale customers.

On approximately one-third of the items sold by the group of manufacturers, there was no distinction between chain grocers and independent retailers as to minimum discounts, and on about one-half of the items, both were subject to the same qualifications for maximum discounts. Where differences in minimum discounts arose from trade classifications, they ranged from two to ten percentage points. Differences in maximum discounts granted chains and independents, where they appeared, ranged from one to twelve percentage points.

Since qualification for the higher discounts depended in most cases on volume of purchases, however, it is difficult to provide a reliable estimate of the differentials that actually prevailed between chains and independents.

While it was noted that the trade discount structure described on the previous page was unusual in the size of the price spreads which it created and in the advantages available to chain grocers, three other manufacturers in that same industry reported a trade discount structure which appeared to make a rather unique distinction between certain types of independent buyers and chain stores. The four suppliers in this industry, reporting on their discounts, granted trade discounts of 7-1/2 per cent to corporate chains and independent stores on purchases over $1,000.00, but voluntary chains operating as a group received only 5 per cent

discounts regardless of the size of group purchases. As one of the four suppliers said, in explaining this policy: "Recognized Voluntary chains or group buyers operating through a central office would qualify for 7-1/2% discount as individual stores if they purchased $1,000.00 in calendar month. However, 5% discount is the most that this category of buyer can receive as a group, because they are composed of small or comparatively small store[s], individually owned and buying as a group through a central office, therefore this group as a whole can qualify for only 5% discount."

With minor exceptions, the manufacturers in this group extended quantity discounts to chain stores only when they were on the same basis as other retailers for trade discount purposes. While it cannot be assumed that even the larger dealers would ordinarily qualify for the highest quantity discounts in all such cases,[1] it was reasonably clear in most cases that it would not be feasible for independent retailers to do so. This will be apparent from the following examples:

| | Maximum Quantity Discount (Approximate) | Quantity to Earn Maximum Discount |
|---|---|---|
| (1) | 11% | Carload |
| (2) | 7% | Carload |
| (3) | 5% | 10 Dozen Merchandise |
| (4) | 3% | 100 cases |

With the exception of the first example, the products to which the above applied included items involving a risk of deterioration if stored for long periods. The manufacturer of the first item stated that most independent retailers were able to qualify for a six per cent discount. In the third example cited, it appeared that some independent grocers of intermediate size would be able, from time to time, to take delivery of the quantity required for discount purposes.

Cumulative discounts employed by manufacturers in this group appeared to be of greater interest to individual retailers than those used by manufacturers stipulating minimum shipment qualifications. Some manufacturers provided one cumulative discount structure for independent retailers and a second for chain grocers.

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1. One manufacturer of perishable items stated that, at the time, no chain grocer in Eastern Canada was in a position to warehouse quantities which would earn the maximum discount.

Discounts to the former, on a weekly, monthly or yearly basis, appeared, in minimum brackets at least, to be within the reach of many dealers in the class. A firm selling tea and coffee, for example, provided a range of allowances to retailers based on purchases of 24, 48 and 100 pounds weekly, and the largest discount so available created net prices equal to or lower than the basic prices to chain grocers. The scale of cumulative discounts to chain grocers in this instance contemplated purchases in considerably larger quantities. Chain grocers earning the maximum cumulative discount would have received net prices about one cent per pound below lowest prices to independents on coffee, and about three cents per pound below lowest prices to independents on tea. Incandescent lamp manufacturers provided a discount to independent dealers purchasing goods valued at $500.00 per year, and chain stores could receive a discount beyond that available to independents only when purchases totalled $15,000.00 in a year. One firm in this industry reported granting a discount of between 40 - 50 per cent to jobbers, the actual size of the discount depending on competitive conditions. It reported that, "We . . . find it necessary to take into account the trade condition in certain areas and offer our highest discounts where competition is keenest."

The most extreme application of cumulative discounts encountered applied to the price schedule of a manufacturer who used no other system of price differentiation. In this case, the minimum discount of 2-1/2 per cent was allowed on monthly purchases of $100.00. This was graduated up to 5 per cent and 7-1/2 per cent at intervals of $500.00 and $1,000.00 respectively. Further discounts, again ranging from 2-1/2 per cent to 7-1/2 per cent were allowed on yearly purchases, the minimum being granted on purchases totalling $100,000.00 per annum and the maximum applying to purchases of $1,000,000.00. Another manufacturer, whose quantity discounts to independent retailers appeared to make it practical for the larger independents to equal the basic price to chain stores, offered chain stores further cumulative discounts of which the maximum was about 8-1/2 per cent. In this case, as in others where a cumulative discount structure was made available to chain stores or chains and wholesalers exclusively, the quantities to which the discounts related were considerably above the normal potential of independent retailers.[1]

1. To earn maximum cumulative discounts, it was frequently necessary for chain stores to purchase goods to the value of more than $100,000.00 annually from the manufacturer concerned. Of 1,452 returns tabulated in a study of operating results of independent retail grocery and combination meat and grocery stores for 1954 only 310 showed annual sales of $100,000.00 and over. It was indicated that average annual purchases for stores in this group of 310 would be less than $150,000.00. Dominion Bureau of Statistics: Operating Results and Financial Structures Retail Food Stores, 1954.

Concluding Comments

The data reviewed in this chapter cannot be precisely summarized but one or two comments of a general nature can be made. First, although there were cases in which wholesalers were granted better buying terms than corporate chains, and other cases in which the corporate chains enjoyed the advantage, there was no general tendency to place either of these groups in a preferred position.

Second, perhaps the chief basis for differentiation of prices among buyers, otherwise buying on equal terms, was found in cumulative (volume) discounts. In some cases, potential differentials on this ground were "substantial", and in a few cases they were very large, in terms of margins in this field.

Third, although manufacturers were invited to set out in their replies the basis on which prices to different buyers or categories of buyer were arrived at, few took advantage of the invitation. Whether this was because their discount structures had grown up in a manner that made analysis difficult, as was suggested by some suppliers in personal interview, or whether the complexities involved were such as to make accurate description difficult, it is impossible, in general, to say. The only basis for discounts mentioned in replies to the questionnaire, and this in only a very few cases, was that the discounts were granted to meet competitors' prices. Some very rough approach to a "cost justification" basis was also advanced in personal interview in one or two cases. However, on the whole - if one may judge from the replies received in this survey - the discount structures of many of the major suppliers of grocery products in Canada have been the product of intuitive adjustment at some stage over a period of years rather than of systematic calculation based on profit or cost considerations. This might have been expected, and it does not follow, of course, that they are therefore necessarily any the less well adapted to their function. Price-making is not a precision process. At the same time, there is a danger that discount structures will become "traditional" and will continue in force long after the conditions that called them into existence have disappeared. A supplier has, for example, reported that the origin of a particular discount classification was "lost in antiquity". In such cases, it may be that a careful review of discount structures in the light of changing distribution patterns would be in the best interests not only of a healthy distribution system but, equally to the point, of the supplier, himself.

ANNEX I

Room 746, Justice Building

Dear Sirs:

We have lately received a considerable number of representations to the effect that the competitive position of certain classes of dealers, and particularly smaller independent dealers, is being unfairly prejudiced by the prices at which they must buy, compared with their larger competitors.

In view of the wide interest in this matter, we have commenced a general inquiry to try to determine the extent to which prices differ among different classes of customers, the circumstances in which such differences chiefly occur, and some of the results.

I should be obliged therefore, if you would let me have certain information, as indicated on the attached questionnaire, with regard to the products mentioned above.

If, in your opinion, other information would be of assistance in understanding your pricing structure, will you please add any further details that you consider helpful.

I should also welcome any general comments you care to make as to the considerations upon which the variations in discounts or net prices to different groups or classes of buyers, at a given level of distribution were arrived at. I would appreciate as well receiving your observations as to the effects of such variations by way of bringing about differences in retail prices or otherwise.

If you find that some of the information requested can be more conveniently supplied by submitting your price lists, please do so.

I should be much obliged if you would let me have this information by . . . .

Yours very truly,

T. D. MacDonald,
Director.

## ANNEX I

## SCHEDULE I-G

The purpose of the following questions is to obtain the complete picture of your sales program and, if there are aspects which these questions do not cover, you are requested to describe them. For example, if a part of your sales are negotiated sales, please supply full information concerning them; where a customer must fulfil special conditions before being recognized in a particular buying category or before being granted a discount or other concession, please set out in full the nature of such conditions.

Every effort will be made to avoid disclosure of such information as is to be regarded as confidential.

(1) (a) List the different categories of buyers which you recognize and set out in detail the qualifications as to quantity (single sales and over a period), conditions of delivery, or other factors, that determine the category granted to each buyer.

(b) List the trade and other discounts or rebates applicable to each category, being careful to list the exact percentage discount or rebate for each category.

(2) If different categories of buyers are not distinguished by different discounts or rebates from a common list price but by some other method such as different list prices, describe fully so as to show how the net price for each buyer or category of buyers is arrived at, and set out the precise price applicable to each buyer or category of buyers.

(3) (a) List any buying concessions of any kind (advertising allowances, delayed billing, split deliveries, etc.) which are given and which do not fall into the category of discounts or rebates, specify the categories of buyers to whom and the circumstances in which such concessions are given, and, where

applicable, give the percentage or dollar values for the allowances or other concessions

(b) Specify the purpose of any such allowance or concession.

(4) List your five largest accounts and indicate specifically any respects in which their buying position is not completely covered by the previous paragraphs.

CHAPTER V

# SPECIAL DISCOUNTS AND ALLOWANCES

## Basis of Information

On September 24, 1954, a questionnaire on special discounts and allowances (Annex I) was sent to representatives of the fourteen principal chain store organizations in Canada. The questionnaire was accompanied by a letter (Annex I) explaining the connection between this survey on special discounts and allowances and the study on loss-leader selling which had been published a few months previously.

The questionnaire consisted basically of a request for two kinds of information. First, it asked the chain stores to list all the suppliers of resaleable goods from whom they received special discounts and/or allowances. For purposes of the inquiry, such special discounts and allowances were defined as "all those forms of discount and allowance which do not appear on the face of the invoice."[1]

Second, the questionnaire asked the chain stores to state the total dollar value at net invoice price of all merchandise purchased either during the calendar year 1953 or in their last fiscal year. Along with these total purchases the chain stores were to

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1. Cash discounts, which are customarily shown on the face of the invoice, were therefore excluded from the category of special discounts and allowances. This exclusion was deliberate and was considered to be appropriate by the executives of certain suppliers who acted as consultants and who supported the view that the cash discount was open to all buyers on similar terms and that it was paid only if it was earned. Suppliers' replies to the questionnaire on special discounts and allowances established that this was true in the great majority of cases. There were, however, a few cases in which cash discounts were granted only to certain buyers, and a very small number of cases in which cash discounts were paid even if they were not earned.

list the total dollar amounts of all special discounts and allowances received by them during the period selected. In addition they were asked to give, at net invoice price, the total dollar value of those merchandise items on which special discounts and allowances were given. This involved the exclusion from total purchases of all those purchases on which special discounts and allowances were not received. "Net invoice price" as referred to in the questionnaire was defined as the "net price after deduction of all discounts shown on invoice". Cash discounts were, however, not to be deducted.

Thirteen of the fourteen chain-store organizations were able to provide the greater part of the information requested in the questionnaire and the results of the request for information on their purchases and special discounts are shown in the left-hand section of Table 5-3. For purposes of further analysis only the seven corporate chains listed in the next questionnaire - "Questionnaire on Special Discounts and Allowances - Suppliers" (Annex II) were dealt with separately and only these are included in the individual breakdowns given in Table 5-3.[1]

The majority of the chain stores found it impossible, however, to differentiate purchases on which special discounts and allowances were received from those on which special discounts and allowances were not received and this difficulty is reflected in the section of Table 5-3 referred to above, where only total dollar purchases and total discounts and allowances are given. It should be noted further that the list of chains as given in Table 5-3 is ordered in terms of the size of purchases and not as they are listed in the questionnaire to suppliers on special discounts and allowances.

In connection with another survey, a list was compiled for the Director, by leading retail and wholesale distributors of

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1. The basic factor accounting for the restriction of the detailed analysis of sales and special discounts and allowances for individual chains to the seven largest corporate chain stores is that the questionnaire to suppliers on special discounts and allowances, in order to limit somewhat the amount of work on the part of suppliers, listed specifically only the seven largest chains and grouped other corporate chains under one general heading.

representative grocery products with a relatively high rate of turnover. These products were said by the distributors to account for a substantial proportion of total sales. On the basis of the list of suppliers of these products together with the lists of suppliers reported by chain stores as granting special discounts and allowances, a "master list" was compiled which, after the elimination of duplications, contained the names of 557 suppliers.

The "Questionnaire on Special Discounts and Allowances - Suppliers" (Annex II) was sent to each of these 557 suppliers. It requested information for certain specified corporate chains, wholesalers and voluntary chain groups and for the residual buyers in each such category concerning the total sales value of finished goods sold to each such buyer or residual buyers and the total amount of special discounts and allowances broken down by the kind of such discount or allowance. Not all the firms were able to provide the information requested. Some stated that they acted as agents for the suppliers, and the suppliers did the invoicing themselves. Some stated that the firm had changed hands and they did not have the records necessary to provide the information. A considerable number stated that their records were not set up in such a way as to enable them to provide the information. And others stated that they were subsidiaries of firms which had already replied to the questionnaire, and the figures for the subsidiaries had been included in the parent's return. These and other factors accounted for 102 firms, leaving 455 suppliers who supplied part or all of the information requested.

In tabulating the data received from the 455 firms which gave some or all of the information it was found that a number of these failed to give breakdowns of their figures sufficient to warrant their inclusion in any further analysis and they were dropped from the study. In a number of instances this procedure was followed only after lengthy discussions with the firms concerned, in which the impossibility or extreme difficulty of providing more specific and comprehensive data was established. After all deletions had been made, the survey was left with returns from 336 firms, upon which the data, as presented in Table 5-1, are based.

Sales and Special Discounts and Allowances by Category of Buyer

Sales and special discounts and allowances for the 336 suppliers referred to above were broken down and assigned to the

four broad categories of dealers[1] listed in the first column of Table 5-1. As the second column of this table indicates, not one of these four categories of dealers or buyers made purchases from all of the 336 suppliers listed. The number of suppliers selling to each category of dealer ranges from 311 in the case of corporate chains to 168 in the case of voluntary chains.

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1. Seven categories of buyers were listed in the questionnaire on special discounts and allowances sent to suppliers: specified large corporate chains, all other corporate chain stores, specified grocery and drug wholesalers, all other grocery wholesalers, specified voluntary chain groups, all other voluntary chain groups, and all other accounts. For the purposes of Table 5-1 the first six groups were consolidated into three larger categories.

## TABLE 5-1

### TOTAL SALES AND SPECIAL DISCOUNTS AND ALLOWANCES, BY MAJOR CATEGORIES OF BUYER, OF ALL SUPPLIERS

| (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | (10) |
|---|---|---|---|---|---|---|---|---|---|
| | | Sales | | Special Discounts & Allowances | | | Sales and Special Discounts and Allowances with some Regrouping of Chains and Wholesalers * | | |
| Kinds of Buyers | Number of Suppliers Selling to Each Kind of Buyer | Amount | Per Cent of Total Sales | Amount | Per Cent of Total Discounts & Allowances | As a Per Cent of Total Sales | Sales Amount | Discounts Amount | Discounts as Per Cent of Total Sales |
| | | $ | % | $ | % | % | $ | $ | % |
| Corporate Chains | 311 | 186,220,759.56 | 26.41 | 3,981,732.58 | 49.42 | 2.14 | 213,844,254.06 | 4,245,283.95 | 1.98 |
| Wholesalers | 285 | 235,284,761.70 | 33.37 | 2,126,411.09 | 26.39 | .90 | 207,661,267.20 | 1,862,859.72 | .90 |
| Voluntary Chains | 168 | 16,495,457.67 | 2.34 | 372,584.91 | 4.62 | 2.26 | 16,495,457.67 | 372,584.91 | 2.26 |
| Other Accounts | 222 | 267,042,301.75 | 37.88 | 1,576,395.35 | 19.57 | .59 | 267,042,301.75 | 1,576,395.35 | .59 |
| TOTAL | 336 | 705,043,280.68 | 100.00 | 8,057,123.93 | 100.00 | 1.14 | 705,043,280.68 | 8,057,123.93 | 1.14 |

* Four wholesalers: Macdonalds Consolidated Limited (Winnipeg and Vancouver), Kingston Suppliers, and Shelly Brothers, have been taken out of the "wholesale" category and added to the "corporate chain" category.

Total sales of the 336 suppliers amounted to approximately $705, 000, 000.00, of which 26.41 per cent was made to corporate chains, 33.37 per cent to wholesalers, 2.34 per cent to voluntary chains, and 37.88 per cent to "other accounts". The share of sales shown for voluntary chains obviously understates the importance of such distributors in the grocery field. The reason for this understatement is not far to seek. The larger voluntary chains are affiliated with various wholesale grocery firms, and suppliers who make sales to such wholesalers have no basis, in most cases, for distinguishing between re-sales made by these wholesalers to their affiliated chains and to other buyers. Hence only the limited volume of sales that can be specifically identified as being made to voluntary buying groups shows up in this category. The share of total sales going to "other accounts" - 37.88 per cent - is the largest for the four categories. Although there were 222 suppliers who sold to this category of buyer, 55 suppliers accounted for approximately 80 per cent of sales. There are a number of interesting features of the sales made to this category of buyer. First, the suppliers whose sales went in substantial degree (40 per cent or more) to "other accounts" tended very largely to be the firms with large programmes of national advertising. Since sales were made direct to retailers by many of these suppliers this characteristic is understandable. Second, suppliers tended to be concentrated in a few product fields: flour, sugar, soaps and detergents, dairy products, biscuits and confectionery, bakery products, processed canned foods, and tea and coffee. Third, a number of suppliers made a large proportion of their sales to "other accounts" such as hardware wholesalers, drug wholesalers, individual hardware and drug stores, and the like, which were outside the scope of the present study. However, the difficulty of segregating individual accounts resulted in all "other accounts" being grouped together, with the result that sales to this category of buyer are inflated relative to the other categories included.

The relationship between sales to the different categories of dealers and special discounts paid is brought out in columns 4, 6, and 7 of Table 5-1. In comparing the percentage of total sales and the percentage of total discounts and allowances going to each type of dealer (columns 4 and 6) it should be noted first that both corporate chains and voluntary chain stores received "favourable" treatment - i.e., the percentage of total discounts and allowances given them by the suppliers is larger than the percentage of total sales made to them by suppliers. In both cases their

percentage of total discounts is almost twice as great as their percentage of total sales. On the other hand, wholesalers received only 26.39 per cent of total discounts and allowances, whereas their purchases amounted to 33.37 per cent of the total sales of suppliers; and "other accounts" received only 19.57 per cent of total discounts and allowances although their purchases constituted 37.88 per cent of the total sales of suppliers. These differences in discount rates between different kinds of buyers are illustrated further in column 7 of Table 5-1. Here it is shown that special discounts and allowances as a percentage of total sales to buyers ranged from a low of 0.59 per cent in the case of sales to "other accounts" to a high of 2.26 per cent in the case of sales to voluntary chains. A point to note is the similarity in the rate of special discounts as between corporate chains and voluntary chains and the wider gulf, on the other hand, between these rates and those accruing to wholesalers and "other accounts".

Columns 8-10 in Table 5-1 were included in the analysis to clarify a certain amount of overlapping between the "corporate chains" and "wholesalers" categories. A number of the 336 suppliers used in this analysis found it difficult to distinguish between sales to corporate chains such as Canada Safeway Limited and O.K. Economy Stores and their subsidiary wholesalers, such as Macdonalds Consolidated Limited (Winnipeg and Vancouver), Kingston Suppliers, both affiliated with Canada Safeway, and Shelly Brothers affiliated with O. K. Economy Stores. Hence, some suppliers reported all sales made to either such chains or wholesalers as being made only to the chains and others reported separately on sales to such chains and wholesalers. The sales and discounts as recorded in columns 3 and 5 take into account the cases in which such sales and discounts were distinguished as between the two categories. Thus, sales and discounts to the subsidiary wholesalers listed above are there included in the "wholesalers" category. In columns 8 and 9 these sales and discounts to subsidiary wholesalers have been deleted from the "wholesalers" category and have been added to the "corporate chains" category.

In making this adjustment, the discounts to corporate chains, as a percentage of total sales (column 10) have fallen to 1.98 per cent while the percentage discount for wholesalers remains at 0.90 per cent. This indicates a percentage discount for these subsidiary wholesalers which is no higher than the average percentage discount given to all wholesalers (and it also accounts, of course, for the decline in the rate of special discounts for corporate chains). In view of the fact that the sales and discounts to these subsidiary wholesalers are closely linked to the "corporate chains"

category, it might be supposed that even where the sales and discounts actually went to the wholesale outlet rather than to the chain, the factors accounting for the higher discounts to chains would be sufficient to raise the discount rate to something near the average "corporate chains" level. Table 5-3, dealing with the sales and discounts of the separate chains, indicates, however, that the two chains of which these wholesalers were affiliates received a percentage discount approximating only 1.05 per cent, less than half of that attributed to the corporate chain category as a whole. A common explanation might be necessary, then, to account for the low discount rates to both these particular chains and their wholesale subsidiaries.

Data for those Suppliers granting Special Discounts and Allowances

Table 5-2 takes account of the fact that not all of the 336 firms from whom data were received in the compilation of total sales and discount figures in Table 5-1 actually granted special discounts and allowances. Altogether, 63 of the 336 firms listed reported that they gave no special discounts and allowances to any of their buyers. In compiling the totals of Table 5-2 the sales of these 63 firms were eliminated. The table is thus based on the information received from the 273 firms which did grant discounts and allowances.

Nor did all of these 273 firms sell to buyers in each of the four categories of distributors. Only 144 of the 273 firms granting special discounts reported sales to voluntary chains, whilst 263 of the 273 made sales to corporate chains. These numbers, as given in column 2 of Table 5-2, do not necessarily represent the numbers of firms that actually give discounts and allowances to buyers in these separate categories. In each case they indicate only the number of firms that granted special discounts and allowances to some category of buyer and made sales to the category of buyer under consideration. Thus, in the sales totals of column 3, Table 5-2, are included sales unaccompanied by discounts to the specific category of buyer, although the supplier making such sales granted special discounts or allowances to at least one buyer in one or more of the four categories of distributors. These will be referred to as sales made by "discount-paying suppliers". Columns (8) and (9) of this table introduce a further sub-classification in that they include only those suppliers (and their sales) who granted special discounts and allowances to buyers in the category in which they (and their sales) are listed. These will be referred to as "specific-discount suppliers". For example, for sales to be included in columns (8) and (9) of the "corporate chains" category the supplier must have actually granted special discounts and allowances on its sales to buyers in this category.

TABLE 5-2

DISTRIBUTION OF SALES OF SUPPLIERS GRANTING SPECIAL DISCOUNTS AND ALLOWANCES

| (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | (10) | (11) |
|---|---|---|---|---|---|---|---|---|---|---|
| Kind of Buyers | Number of Suppliers Giving Special Discounts and Making Sales To Buyers But Not Necessarily Giving Discounts to Each Buyer | Sales | | Special Discounts and Allowances | | | Number of Suppliers From Which Each Type of Buyer Actually Received A Discount | Sales | | Discounts and Allowances As a Per Cent of Sales |
| | | Amount | Per Cent of Total | Amount | Per Cent of Total | As a Per Cent of Sales | | Sales on Which Specific Dis-counts Were Received, Amount | Per Cent of Total | |
| | | $ | % | $ | % | % | | $ | % | % |
| Corporate Chains | 263 | 168,904,158.50 | 27.36 | 3,981,732.58 | 49.22 | 2.34 | 242 | 166,972,459.48 | 34.05 | 2.37 |
| Wholesalers | 227 | 190,782,019.50 | 30.88 | 2,126,411.09 | 26.49 | 1.11 | 167 | 168,528,098.26 | 34.36 | [illegible] |
| Voluntary Chains | 144 | 15,046,479.38 | 2.44 | 372,584.91 | 4.65 | 2.47 | 79 | 13,722,842.70 | 2.80 | 2.71 |
| Other Accounts | 184 | 242,694,726.15 | 39.32 | 1,576,395.35 | 19.64 | 0.65 | 91 | 141,137,330.15 | 28.79 | 1.12 |
| TOTAL | 273 | 617,427,383.53 | 100.00 | 8,057,123.93 | 100.00 | 1.30 | 273 | 490,360,730.59 | 100.00 | 1.64 |

The data in Table 5-2 make possible some interesting comparisons and contrasts. It will be noted, for example, that the "other accounts" category accounted for 28.79 per cent (column 10) of all "specific-discount sales" while receiving only 19.64 per cent (column 6) of total discounts and allowances. It might be supposed that one reason for the relatively low percentage of total discounts accruing to "other accounts" lay in the small number of "discount-paying suppliers" that sold to this category. Referring to column 2, it is evident that "other accounts" did in fact make purchases from two-thirds of all "discount-paying suppliers" (184/273). However, by comparing columns 2 and 8, the more basic influence becomes apparent - although 184 of the "discount-paying suppliers" made sales to "other accounts", only 91 or slightly less than half of these were "specific-discount suppliers". On the same basis, slightly more than half (55%) of the "discount-paying suppliers" selling to voluntary chains were "specific-discount suppliers"; 74 per cent of the "discount-paying suppliers" selling to wholesalers were "specific-discount suppliers"; whereas 92 per cent of the "discount-paying suppliers" selling to corporate chains were "specific-discount suppliers".

The case of the voluntary chains raises another point of interest. Although this type of buyer evidently possesses the qualifications necessary to obtain relatively large discount rates on its purchases, it does not appear to be successful in obtaining discounts and allowances from a high percentage of its suppliers. That is, if a high degree of correlation is assumed between the ability to induce a high percentage of suppliers to grant discounts, and the ability to obtain a high percentage rate of discounts on purchases, such a relationship does not hold in the case of the voluntary chains. With the highest percentage rate of discounts on purchases of the four categories of buyer (columns 7 and 11, Table 5-2), voluntary chains rank third in their ability to obtain special discounts from a high proportion of "discount-paying suppliers" (about 55 per cent). The other three categories, taken by themselves, would, however, fit more or less closely into the assumed relationship.

Within these three remaining categories, (i.e., corporate chains, wholesalers, and other accounts) "corporate chains" display the greatest success in obtaining special discounts from a large percentage of "discount-paying suppliers" - 92 per cent - while at the same time they have the highest rate of special discounts of the three - viz., 2.34 per cent on all purchases from such suppliers and 2.37 per cent on all purchases from "specific-discount suppliers" (see Table 5-2, columns 7 and 11 respectively). On the other hand, "other accounts", which have found the most difficulty of the three

categories in obtaining special discounts from a large percentage of "discount-paying suppliers" (49 per cent) have also obtained the lowest rates of special discounts on their purchases, viz., 0.65 per cent on all purchases from "discount-paying suppliers" and 1.12 per cent on all purchases from "specific-discount suppliers". On the basis of both these criteria the "wholesalers" category falls in between, with special discount rates of 1.11 and 1.26 per cent, whilst obtaining special discounts from 74 per cent of the "discount-paying suppliers". However, these factors do not tell the whole story.

There is a further factor and that is the practice of different buyers to "discriminate" in their purchases to a more or less marked degree between those suppliers who do grant them special discounts ("specific-discount suppliers") and those who do notgrant them such discounts, although granting them to other buyers. This apparently characteristic aspect of behaviour of the different categories of buyer can be illustrated in a number of ways.

First, if the number of "specific-discount suppliers" is expressed as a percentage of the number of "discount-paying suppliers" for each category of buyer; and the sales of the former group of suppliers as a percentage of the sales of the latter group of suppliers for each category of buyer, the following relationships result.

| Category of Buyer | "Specific-discount suppliers" (A) as a percentage of "discount-paying suppliers" (B) | Sales of (A) as a percentage of sales of (B) |
|---|---|---|
| | % | % |
| Corporate chains | 92 | 99 |
| Wholesalers | 74 | 88 |
| Voluntary chains | 55 | 91 |
| Other accounts | 49 | 58 |

That is, "specific-discount suppliers" accounted for 92 per cent of "discount-paying suppliers" selling to chains but they accounted for 99 per cent of sales by "discount-paying suppliers" to chains. In other words, the eight per cent of "discount-paying suppliers" who paid no discounts to chains made only one per cent of the group sales to chains. The reader can apply the same formula to the percentages for the other categories of buyer, noting particularly "voluntary chains" and "other accounts".

This behaviour can be illustrated in another way. Ratios showing the relationship for each category of buyer between (1) average sales of suppliers, who did not grant special discounts to buyers in the categories listed although otherwise granting special discounts, and (2) average sales of suppliers, who paid discounts to buyers in each of the specific categories listed, may bring out the point more precisely. The former is shown as "1" in each case.

| Category of Buyer | Average sales of suppliers on which discounts were paid to specific category of buyer | Average sales of discount-paying suppliers not paying discounts to specific category of buyer |
|---|---|---|
| Corporate chains | 7.5 | 1 |
| Wholesalers | 2.7 | 1 |
| Voluntary chains | 8.5 | 1 |
| Other accounts | 1.4 | 1 |

Inasmuch as the category "other accounts" includes some buyers outside the grocery field, there may be special factors contributing to the result for this group; in view of the limited information available on the buyers included, it is impossible to make any attempt to assess their possible importance. For the three remaining categories, the data make it clear that voluntary chains and corporate chains have a pronounced tendency to make much larger purchases from suppliers that grant them discounts on their purchases than is the case with wholesalers. This relationship, taken together with the data quoted above on numbers of discount-paying suppliers actually granting discounts to various categories of buyer, poses some highly interesting questions as to the bargaining relationships between supplier and buyer, which the data available in the present survey can do little to answer.

Special Discounts and Allowances to Corporate Chains

Table 5-3 presents a breakdown of sales and special discounts and allowances to corporate chains. The table presents similar information derived from two different sources. The left-hand side of the table presents data on sales and discounts obtained from the corporate chains themselves through the questionnaire referred to earlier in Annex I. The right-hand side, beginning with column 7, presents data on sales and discounts to corporate chains obtained from the 311 suppliers reported in this

survey as selling to these chains.

As has been indicated previously, only the seven largest chains have been listed individually in this table. The other chains to which the manufacturers reported making sales are shown under a separate category, "other corporate chains". No comparative data for this group are, of course, available from the chain-store questionnaire which was sent only to the larger corporate chains. Sales and discounts to subsidiary wholesalers of corporate chain stores are included in this table in the sales and discount figures of the parent chains.

A number of points should be noted in regard to the figures set out in Table 5-3. First, the order of the firms as listed is based on size of purchases as reported by the chains (column 2). The order on the basis of sales to chains as reported by suppliers (column 7) is the same, with one exception. That is, chains (3) and (4) in column 2 switch positions in column 7. Since chain (3) has a number of subsidiary suppliers which provide it with part of its purchases, the switch in position with chain (4) on the basis of purchases from "outside" suppliers is not surprising.

The amount of purchases as reported by chains is approximately three times as great as the sales to chains reported by suppliers. Since the coverage of suppliers was limited to those selected as sellers of "representative grocery products" and those reported by chain stores as granting special discounts and allowances, anything approximating a complete report of sales to chains would not be possible. However, in reporting the relative positions of different buyers the figures from suppliers, as has been pointed out, give highly consistent results. The similarity of the percentages of total sales going to each corporate chain on the basis of purchases as reported by chains (column 3) and of sales as reported by suppliers (column 8) is also impressive. In only one case is there a difference of as much as two percentage points between the two bases. In this one case, chain (4) had 15.48 per cent of total purchases reported by the seven corporate chains and 17.67 per cent of total sales to the seven chains reported by the 311 suppliers.

It will be noted that the coverage of discounts given by suppliers is much more complete than that found in the reports on sales. Almost 100 per cent of total discounts reported by the seven chains have been recorded by the 311 manufacturers included in this survey. This result would tend to follow in a general way because of the basis employed in selecting the suppliers to whom the questionnaire on special discounts and allowances was sent - that is, among others, all suppliers reported by the corporate chains as granting special discounts and allowances.

TABLE 5-3

SPECIAL DISCOUNTS AND ALLOWANCES TO CORPORATE CHAINS

| (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) | (9) | (10) | (11) |
|---|---|---|---|---|---|---|---|---|---|---|
| | Reported by Chain Stores | | | | | Reported by Suppliers | | | | |
| | Purchases | | Discounts and Allowances | | | Sales | | Discounts and Allowances | | |
| Corporate Chains | Amount | Per Cent of Total | Amount | Per Cent of Total | As a Per Cent of Purchases[1] | Amount | Per Cent of Total | Amount | Per Cent of Total | As a Per Cent of Sales |
| | $ | % | $ | % | % | $ | % | $ | % | % |
| (1) | 155,905,351.00 | 27.72 | 1,473,870.00 | 35.48 | .95 | 50,201,578.64 | 26.92 | 1,300,022.99 | 33.17 | 2.58 |
| (2) | 118,173,894.00 | 21.01 | 949,883.61 | 22.86 | .80 | 35,956,245.19 | 19.28 | 858,304.51 | 21.93 | 2.38 |
| (3) | 99,654,279.89 | 17.72 | 204,489.34 | 4.94 | .20 | 31,108,815.82 | 16.68 | 324,669.29 | 8.27 | 1.04 |
| (4) | 87,057,828.20 | 15.48 | 715,075.84 | 17.21 | .82 | 32,940,473.68 | 17.67 | 688,440.51 | 17.54 | 2.08 |
| (5) | 66,624,664.00 | 11.85 | 499,615.00 | 12.02 | .74 | 24,845,231.48 | 13.32 | 534,887.75 | 13.56 | 2.15 |
| (6) | 28,667,963.00 | 5.10 | 284,393.53 | 6.84 | .99 | 7,988,712.77 | 4.28 | 181,688.76 | 4.60 | 2.27 |
| (7) | 6,198,771.16 | 1.12 | 26,172.46 | .65 | .42 | 3,453,900.85 | 1.85 | 36,315.95 | .93 | 1.05 |
| Total | 562,282,751.25 | 100.00 | 4,153,499.78 | 100.00 | .74 | 186,494,958.43 | 100.00 | 3,924,329.76 | 100.00 | 2.10 |
| Other Corporate Chains | 39,024,488.16 [2] | - | 562,481.95 [2] | - | 1.44 [2] | 27,349,295.63 [3] | - | 320,954.19 [3] | - | 1.17 [3] |

1. For purposes of comparison, net profits (after taxes) as a per cent of sales for five of the seven chain stores listed, varied within a range of 1.80 per cent to 2.23 per cent, three of the chains earning less than two per cent.

2. These data refer to the six remaining chains from which replies were received to the questionnaire on "Special discounts and allowances - Chain stores". It is of interest to note that two chains, both under the corporate control of wholesalers, together accounted for purchases of $14,446,165.76 (37% of the total) and received special discounts and allowances amounting to $439,958.97 (78% of the total).

3. These data refer to a residual category "all other corporate chain stores" in the questionnaire on special discounts and allowances sent to suppliers.

In terms of dollar amounts, special discounts and allowances received by (and paid to) the seven listed corporate chains do not follow the order determined by the magnitude of purchases (or sales). On the basis of their own reports on special discounts received, the chains are arranged in the following order, from high to low: (1), (2), (4), (5), (6), (3), (7). On the basis of special discounts reported by suppliers, the order is: (1), (2), (4), (5), (3), (6), (7), so that (6) and (3) have changed positions in the latter ordering as compared with their position in the former.

The absolute figures for these two chains raise a question as to the relationship between the detailed figures, as distinct from the totals, reported from the two sources - chains and suppliers. Substantial discrepancies exist for at least two cases - chains (3) and (6) - with moderate differences for at least two others. Corporate chain (3) reported receiving special discounts amounting to $204,489.34, but was reported by suppliers as receiving $324,669.29. In this case, sales and special discounts reported by suppliers as being paid to subsidiary wholesalers were added to the sales and discounts reported as being paid to the parent chain store and this factor accounts in full for the apparent discrepancy. Corporate chain (6) reported receiving special discounts and allowances amounting to $284,393.53 but was reported by suppliers as being paid $181,688.76. There is no obvious explanation of this large divergence between the two figures.

In spite of these apparent discrepancies the percentage of total special discounts going to each corporate chain is again highly uniform, whether the source of the data is the chain stores themselves or the suppliers of chains. Comparing columns 5 and 10 of Table 5-3 there are only two instances - chains (3) and (6) - in which the difference between the percentage of total special discounts as reported by the chains and as reported by the suppliers, appears to be substantial, and the case of the divergence between the two bases on which special discounts were reported for these chains has already been referred to.

Turning, next, to the rate of special discounts and allowances as a percentage of purchases (and sales) as reported in columns (6) and (11), it is clear that there is no regular progression from a high discount rate accruing to chains with the largest purchases to lower discount rates obtained by chains with smaller purchases. On the basis of data reported by corporate chains, the order from high to low of these percentages is: (6), (1), (4), (2), (5), (7), (3). On the basis of suppliers' data, the order is: (1), (2), (6), (5), (4), (7), (3). "Other corporate chains" would

stand above both chains (7) and (3) in this latter listing. It will be recalled that the original ordering from (1) through (7) was on the basis of purchases reported by the chains (and remained the same on the basis of suppliers' reports with the exception of the switching of positions by chains (3) and (4)). Hence the relationship between the relative size of over-all purchases and the ability to obtain a commensurate rate of special discounts would appear, on inspection, to be more closely approximated on the basis of suppliers' data than of chains' data.[1]

## Special Discounts and Allowances to Wholesalers[2]

Table 5-4 presents a breakdown of sales and special discounts to wholesale firms, which were, with one exception, grocery wholesalers. The exception, a drug wholesaler, was included in order to establish whether there was any difference in the level of special discounts and allowances on sales of similar products to different types of wholesale distributor. Column 1 of Table 5-4 lists 11 wholesalers for whom suppliers were requested

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1. This general impression is confirmed by a statistical test. The coefficient of rank correlation (Spearman's formula) between the ranks of total purchases as reported by chains and the ranks of average rates of special discounts and allowances is low and negative - -.21; whilst the same computation for data from suppliers yields a moderate, positive correlation of +.54. In view of the limited number of ranks included, too much significance should not be attached to the absolute size of the coefficients, but they do serve to emphasize the contrasting degree of association for the different bases on which the data are reported.

2. The data on sales and special discounts for corporate chains were based on returns from both the chains and suppliers. In the case of wholesalers, the data are based only on suppliers' returns. Inquiries were made among wholesalers as to the possibility of supplying the desired information; however, a number of firms, particularly those with branches and partially decentralized operations, indicated that accurate figures were not available.

to provide information on an individual basis. In addition, there were four wholesale subsidiaries of corporate chains which were listed individually in the questionnaire but which have been combined into one group for the purposes of this report. This group is shown as (12) in Table 5-4. Finally, suppliers were requested to provide data on sales and special discounts to "all other wholesalers" and this group is reported as (13).

As has been pointed out above, 285 of the total of 336 suppliers reported sales to wholesalers and 167 suppliers granted discounts on such sales. The wholesalers in Table 5-4 are arranged in order of the dollar amount of sales made to them, except for numbers (12) and (13) which consist of groups of wholesalers.

One of the first features of interest in the tabulated data is the much lower concentration of sales among wholesalers than among corporate chains. It should be noted that the eleven wholesalers listed individually are thought to be the largest firms in their field in Canada in terms of sales volume. The largest single wholesale firm accounts for only 12.60 per cent of total sales to all wholesalers, as reported by suppliers, whilst the largest corporate chain accounted for 23.6 per cent of total sales reported for chains. The contrast is even more striking on the basis of sales to the five largest buyers in each category. For the corporate chains, these firms accounted for 82.2 per cent of sales, and for the wholesalers 32.1 per cent. In fact, the eleven wholesalers listed individually together accounted for only about 40 per cent of reported sales. On the other hand, the "all other grocery wholesalers" category, presumably consisting of smaller wholesalers, accounted for 47.48 per cent.

With respect to special discounts and allowances, the wholesale firm with the largest share of reported sales (12.60 per cent) received 19.35 per cent of such discounts and allowances, and the firm next in order in share of sales (6.89 per cent) received 10.71 per cent. That is, each firm's share of special discounts was approximately 50 per cent greater than its share of sales. No corporate chain displayed anything approaching this differential. Among the smaller wholesalers, there were also some striking cases, notably firm (7) which, with 1.94 per cent of reported sales, received 5.30 per cent of special discounts. This firm differed from the other wholesalers in that it was the single drug wholesaler included in the survey. Wholesalers (8) and (9) also enjoyed very favourable treatment. Some of the differentials in the opposite direction are also worth noting, such as firm (4), which, with 3.73 per cent of reported sales, received only 2.60 per cent of special discounts, and firm (10) with 0.98 per cent and 0.46 per cent, respectively. This latter case, in terms of percentage relationships, is very close to the situation of chain store (3), which had 14.5 per

cent of sales reported as being made to chains (both the seven specified chains and "other corporate chains") but only about 7.7 per cent of special discounts. The firms grouped together in the "other wholesale grocers" category had a moderately more favourable record than chain (3), with 47.48 per cent of sales and 32.09 per cent of special discounts.

TABLE 5-4

SALES AND SPECIAL DISCOUNTS OF SUPPLIERS TO WHOLESALERS

| (1) | (2) | (3) | (4) | (5) | (6) |
|---|---|---|---|---|---|
| | Sales | | Special Discounts and Allowances[1] | | |
| Whole-sales in Order of Size | Amount | Per Cent of Total | Amount | Per Cent of Total | As a Per Cent of Sales |
| | $ | % | $ | % | % |
| (1) | 29,647,673.00 | 12.60 | 411,646.08 | 19.35 | 1.39 |
| (2) | 16,202,650.62 | 6.89 | 227,931.31 | 10.71 | 1.40 |
| (3) | 12,173,811.35 | 5.17 | 112,488.43 | 5.30 | 0.92 |
| (4) | 8,767,984.62 | 3.73 | 55,434.54 | 2.60 | 0.63 |
| (5) | 8,387,319.72 | 3.56 | 101,005.26 | 4.75 | 1.20 |
| (6) | 7,002,897.76 | 2.98 | 60,636.53 | 2.85 | 0.87 |
| (7) | 4,573,063.36 | 1.94 | 112,661.07 | 5.30 | 2.46 |
| (8) | 2,812,357.22 | 1.20 | 39,045.40 | 1.83 | 1.39 |
| (9) | 2,423,677.34 | 1.03 | 34,962.34 | 1.64 | 1.44 |
| (10) | 2,300,404.84 | 0.98 | 9,955.35 | 0.46 | 0.43 |
| (11) | 1,413,955.64 | 0.60 | 15,455.53 | 0.72 | 1.09 |
| (12) | 27,850,828.50 | 11.84 | 263,551.37 | 12.40 | 0.95 |
| (13) | 111,728,137.73 | 47.48 | 681,637.88 | 32.09 | 0.61 |
| TOTAL | 235,284,761.70 | 100.00 | 2,126,411.09 | 100.00 | 0.90 |

1. The data reported in columns (2) through (6) in this table are to be compared with the data in columns (7) through (11) of Table 5-3, p. 124; both these sets of data being based on returns from suppliers. Row (13) refers to the category "all other wholesalers" in suppliers' returns.

Discount rates as a percentage of sales showed a wider range relative to their means for wholesalers than for corporate chains. In the case of the former, the maximum was 2.46 per cent - omitting the drug wholesaler, the maximum becomes 1.44 per cent - and the minimum 0.43 per cent, whereas for chains, the maximum was 2.58 per cent and the minimum 1.04 per cent. The average rate of special discounts reported for all wholesalers was 0.90 per cent compared with 1.98[1] per cent for chains.

Although it is often assumed that the wholesaler, as well as the chain, with the larger over-all purchases is in a stronger bargaining position and is thus able to obtain more favourable general treatment with respect to the rate of special discounts and allowances, there is even less support for this view in the case of wholesalers than in the case of chains.[2]

A final comparison between discounts to wholesalers and chains can be made on the basis of data received from suppliers who specifically sold to both these categories of buyer. While, as noted previously, there were 242 suppliers who granted special discounts to corporate chains, and there were 167 sellers who extended discounts to wholesalers, there were only 144 suppliers who gave discounts to <u>both</u> corporate chains and wholesalers.

The following comparison is based on the average rates of special discounts given by these 144 suppliers. It does not take into account the relative magnitude of sales of these suppliers to wholesalers and corporate chains.

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1. This is the weighted average of the figures "2.10" and "1.17" in column 11 of Table 5-3.

2. The coefficient of rank correlation (calculated by Spearman's formula) between the ranks of wholesalers based on the size of their total purchases from the suppliers reporting and the ranks of the average rate of special discounts granted by these suppliers for the eleven individual wholesale firms is only +.10, which indicates a very low degree of association. It will be recalled that the coefficient calculated on the same basis for the seven corporate chains was +.54, which, although still below the 5 per cent level of significance, indicates a somewhat higher degree of association between the size of over-all sales and the level of special discount rates allowed by suppliers.

The data indicate that of the 144 suppliers, 99 gave higher average percentage discounts to corporate chains than to wholesalers; 42 gave higher percentage discounts to wholesalers, and three gave the same average percentage discounts to both chains and wholesalers.

Carrying this analysis further, of the 99 manufacturers giving higher average percentage discounts to chains than to wholesalers, 55 gave percentage discounts which were more than twice as great as those going to wholesalers. On the other hand, of the 42 manufacturers giving higher average percentage discounts to wholesalers than to chains, only 15 gave percentage discounts to wholesalers which were more than twice as great as those given to chains.

Sales and Special Discounts on the Basis of Size of Suppliers

The literature on price discrimination devotes a good deal of attention to the question of the bargaining relationships between buyers and sellers of different sizes. In the section on the "Big Buyer" in Chapter II of this analysis, reference was made to the argument that the big buyer performed an important economic function when he succeeded in breaking down established positions in which suppliers were few and large, and pursued tightly co-ordinated policies on price and other aspects of behaviour.

Dr. John M. Blair, Chief Economist of the Sub-Committee on Antitrust and Monopoly of the Committee on the Judiciary of the U.S. Senate and formerly on the staff of the Federal Trade Commission, in dealing with certain proposed amendments to the Robinson-Patman Act, was quoted, in part, as follows:

> "Based on studies of the subcommittee, he said large buyers, having their own monopoly power, tend to by-pass large sellers, also having monopoly power. Thus, the large sellers deal chiefly with small buyers which have no power to bring price reductions."[1]

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1. "Senate Unit to Weigh 'Good Faith' Fate", The Journal of Commerce, New York, April 8, 1957, p. 2.

A.D.H. Kaplan, in Small Business: Its Place and Problems[1], a Committee for Economic Development Research Study, deals with a closely related matter in the following words:

> "What has happened to the relationship between the small manufacturer and the small retailer? The independent retailer, limited in the stock he can carry, naturally gives precedence to standard brands on which the consumer has already been sold by national manufacturer advertising and for which the consumer ordinarily asks by brand name. For the small manufacturer and wholesaler to edge in with an item that must be merchandised by the retailer in competition with already accepted national brands is often next to impossible. . . .
>
> This inability to deal effectively with the small retailer plays the small manufacturer into the hands of the large retailer, whether chain or department store. In a seller's market, such as has prevailed during and since the war, the small manufacturer could have something to say about the terms under which he supplied his main big customer. The more common situation is one in which the large buyer can dictate terms in line with its own pricing policy. Where the whole output of the small manufacturer is contracted for, his position is that much more vulnerable.
>
> The small retailer, having experienced the price-cutting tactics of the large distributor of the familiar national brands, has aligned himself under fair-trade legislation with the large manufacturer of the national brand - indeed, small retailers have frequently put the pressure on the manufacturer to 'fair-trade' his product. To the large retailer is left the aggressive merchandising of the output of small manufacturers."
>
> (pp. 188-9)

The "big buyer" should not perhaps be exclusively identified with the corporate chain, although the data collected in the present analysis make it clear that the larger grocery chain

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1. New York, Toronto, London, 1948.

stores are considerably larger with respect to over-all purchases than the largest grocery wholesalers. Further, the larger chains tend to account for a much larger proportion of total chain store purchases than the larger wholesalers do of total wholesale purchases; and the rate of growth of sales by the leading chain stores has exceeded that for the grocery field as a whole. Hence, it may not involve any serious distortion of fact to identify the "big buyer" with the corporate chain, as is commonly done.

The views quoted above on the relationship between buyer and supplier and the related aspects of the earlier analysis of the role of the "big buyer" can be summarized as follows:

1. One of the major economic functions of the "big buyer" is to force "big suppliers" pursuing interdependent policies into granting discriminatory prices and the like, thus reducing both prices and costs. The "big buyer" is likely to perform this function most effectively if he accounts for a substantial share of the sales of the "big suppliers".

2. The small supplier, however, sells chiefly to the large chain distributor, because, as one writer would have it, wholesalers and small retailers tend to restrict themselves to national brands, or, as another writer would have it, the large chains tend to avoid the large manufacturers because of the latter's monopoly power.[1] The distinction will not, of course, be absolute - large corporate chains will undoubtedly buy from manufacturers of national brands enjoying substantial market power, and wholesalers will buy from smaller suppliers, particularly where private brands may be involved. Some considerable shift in the importance of purchases as between large and small suppliers should, however, be apparent for the different buyers if the above views possess validity.

In this section the data on sales and special discounts and allowances are examined for any light they may throw on these views and more generally on the relationships between different categories of buyers and different sizes of sellers.

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1. It should perhaps be pointed out that the general information available to the Director on supplier-buyer relationships in Canada does not provide clear-cut support for either of these positions.

The data in Table 5-5 are based on returns from 339 suppliers as compared with 336 in the earlier tables in this chapter. Three suppliers, whose returns were not sufficiently detailed to provide the information required in the earlier analysis, did provide sufficient data to be included in the present section. The 339 suppliers have been classified on the basis of their total dollar sales volume into seven size-categories, the smallest with annual sales of less than $500, 000, and the largest with sales of $10, 000, 000 and over. On the buyer's side, two categories are distinguished: the seven major corporate chains as a group, and "all accounts other than chains". Thus from the categories listed in the earlier tables in this chapter, is omitted the "other corporate chains" group. Hence, both by reason of this omission and of the addition of three firms not previously included, the figures in this section cannot be compared with those reported above which were drawn from the same general source.

TABLE 5-5

SALES AND SPECIAL DISCOUNTS AND ALLOWANCES BY SIZE OF SUPPLIER

| (1) Sales Volume of Seller | (2) No. of Sellers | (3) Sales to Seven Chains | (4) Discounts to Seven Chains | (5) Discounts as % of Sales | (6) Sales to Accounts other than Chains | (7) Discounts to Accounts other than Chains | (8) Discounts as % of Sales | (9) Sales of (3) as % of combined Sales of (3) & (o) |
|---|---|---|---|---|---|---|---|---|
| 1. $0-$499,999 | 151 (44.54%) | 10,504,839.43 (6.62%) | 213,294.85 (5.82%) | 2.03% | 16,681,559.63 (3.20%) | 144,905.12 (3.55%) | 0.87% | 38.64% |
| 2. $500,000-$999,999 | 58 (17.11%) | 10,169,730.99 (6.41%) | 193,859.44 (5.29%) | 1.91% | 31,963,933.06 (6.13%) | 224,750.09 (5.51%) | 0.70% | 24.13% |
| 3. $1,000,000-$1,999,999 | 51 (15.04%) | 20,758,496.77 (13.07%) | 446,755.12 (12.20%) | 2.15% | 48,720,114.63 (9.34%) | 312,544.15 (7.66%) | 0.64% | 29.87% |
| 4. $2,000,000-$2,999,999 | 28 (8.26%) | 15,821,192.19 (9.96%) | 541,197.78 (14.77%) | 3.42% | 48,897,142.75 (9.38%) | 567,776.54 (13.92%) | 1.16% | 24.44% |
| 5. $3,000,000-$4,999,999 | 19 (5.60%) | 10,982,334.78 (6.92%) | 227,889.97 (6.22%) | 2.07% | 56,245,619.30 (10.79%) | 654,658.65 (16.05%) | 1.16% | 16.33% |
| 6. $5,000,000-$9,999,999 | 16 (4.72%) | 19,814,952.85 (12.48%) | 351,526.27 (9.60%) | 1.77% | 79,999,331.24 (15.34%) | 271,565.24 (6.66%) | 0.34% | 19.85% |
| 7. $10,000,000 and over | 16 (4.72%) | 70,717,173.57 (44.54%) | 1,688,855.98 (46.10%) | 2.39% | 238,904,841.22 (45.82%) | 1,902,152.91 (46.64%) | 0.80% | 22.84% |
| 8. TOTALS | 339 (100%) | 158,769,220.58 (100%) | 3,663,379.41 (100%) | 2.31% | 521,412,541.83 (100%) | 4,078,352.70 (100%) | 0.78% | 23.34% |
| 9. $10,000,000-$19,999,999 | 9 | 29,139,942.23 | 1,179,243.71 | 4.05% | 84,001,499.69 | 1,564,269.71 | 1.86% | 25.76% |
| 10. $20,000,000-and over | 7 | 41,577,231.34 | 509,612.27 | 1.23% | 154,903,341.53 | 337,883.20 | 0.22% | 21.16% |

The major chains accounted for 23.3 per cent of total sales reported in Table 5-5, and for 47.3 per cent of total special discounts and allowances. Their over-all percentage rate of special discounts and allowances was 2.31 per cent, whilst that for "accounts other than chains" was 0.78 per cent, about one-third of the chains' figure.

It will be noted from column (2) of Table 5-5, that the smallest size-category of seller accounted for almost 45 per cent of total numbers. From columns (3) and (6) it would appear that this category accounted for only four per cent of total sales included. The largest size-category with 4.7 per cent of numbers accounted for slightly more than 45 per cent of sales included. For certain sections of the analysis this latter group will be further sub-divided into suppliers with total sales of $10, 000, 000 to $19, 999, 999 (nine suppliers), and those with sales of $20, 000, 000 and over (seven suppliers).

In examining the assumed tendency of the major chains and of "other accounts" to concentrate their purchases on large or on small buyers, it is important to keep in mind their relative over-all buying positions. In the present case, if the major chains were to allocate their purchases among the seven size-categories of suppliers in the proportion which their purchases constituted of the sales of all suppliers included in Table 5-5, then sales to chains would account for 23.34 per cent of the sales of each size-category of supplier. The actual percentages which the major chains accounted for by size-category of supplier were (see column 9, Table 5-5):

| | |
|---|---|
| 1 - 38.64% | 5 - 16.33% |
| 2 - 24.13 | 6 - 19.85 |
| 3 - 29.87 | 7 - 22.84 |
| 4 - 24.44 | |

Thus the major chains made purchases from the four smallest size-classes which were above their average percentage for the whole group of suppliers, and from the three largest size-classes that were below their group average. The proportion of sales to the major chains within each sub-group is not, however, highly consistent with this general relationship. Within the group of four classes of "small" suppliers, the chains account for a relatively high proportion of sales of the smallest suppliers as compared with their "normal proportion"; in the next larger size-class, however, the major chains' share falls back to 24.13 per cent, only slightly

in excess of their "normal proportion" (23.34 per cent); in the next larger size-class, the chains' share again rises, and in the next, it falls back to a level slightly above "normal". For the three largest size-classes, although the smallest of the three (suppliers with sales of \$3, 000, 000 to \$4, 999, 999) made a substantially smaller proportion of its sales to major chains (16.33 per cent) than "normal" (23.34 per cent), the two larger size-classes showed a steady increase in the proportion of sales to major chains, with the largest size-class coming very close to the "normal" percentage. Indeed, if class "7" (\$10, 000, 000 and over) is sub-divided into two groups: suppliers having sales of \$10, 000, 000 to \$19, 999, 999 and those having sales of \$20, 000, 000 and over (see rows "9" and "10", Table 5-5), the former group's sales to chains actually rise above the "normal" percentage (25.76 per cent against 23.34), although the latter's sales fall off to 21.16 per cent.

Hence, although there is a general tendency for chains to make a higher than "normal" proportion of their purchases from small suppliers and a lower than "normal" proportion from large suppliers, there may be some question whether this relationship is sufficiently well-defined to give <u>decisive</u> support to the views of Kaplan and Blair quoted above.

Nor do the rates of special discounts and allowances paid by large and small suppliers to different buyers help very much. If the first four size-classes in Table 5-5 are grouped together as "small" suppliers and the remaining three size-classes grouped as "large" suppliers, the average rates of special discounts and allowances to the two categories of buyer are as follows:

| | Seven corporate chains | Accounts other than chains |
|---|---|---|
| "Small" suppliers | 2.44% | 0.86% |
| "Large" suppliers | 2.24% | 0.76% |

Although, as already pointed out, the rate to the seven corporate chains is approximately three times as great as that to accounts other than chains, the "small" suppliers pay slightly higher rates to both categories of buyer than the "large" suppliers, and the percentage differential is of roughly the same order of magnitude as between the two categories of buyer for the two sizes of supplier. Furthermore, the trend within each of the two groups of suppliers is not consistent with the apparent general trend for large suppliers to pay lesser rates of special discounts than small

suppliers. For chain buyers (see column (5), Table 5-5) the highest rate among "small" suppliers is paid by those in size class "4", and the highest rate among the "large" suppliers is paid by those in size-class "7". Further, if the "$10, 000, 000 and over" group of suppliers is subdivided into the two groups shown in Table 5-5 (see rows "9" and "10"), the "smaller" suppliers (sales of $10, 000, 000 to $19, 999, 999) pay the astonishingly high rate of 4.05 per cent - the highest for all groups - and the larger suppliers (sales of $20, 000, 000 and over) pay only 1.23 per cent, the lowest rate for any group shown.

The general pattern for special discounts to accounts other than chains is very much the same, with one major exception. In the "large" suppliers group (size-classes "5", "6" and "7"), the highest rate of special discounts is paid not by number "7", as with the major chains, but by number "5". Although if size-class "7" is again subdivided into the two groups referred to in the preceding paragraph, suppliers in the $10, 000, 000 to $19, 999, 999 sales-volume category pay the highest rate of special discounts and allowances recorded for all groups. The extremely low percentage rate of special discounts (0.22 per cent) paid by suppliers in the $20, 000, 000 and over group to this category of buyer should also be noted.

It is difficult to trace any consistent pattern in these data. Perhaps their most striking feature is the fact that the maximum and minimum rates paid to both categories of buyer are found in the sub-groups of the "$10, 000, 000 and over" size-class. The sub-group with the smaller sales volume ($10, 000, 000 to $19, 999, 999) is apparently much less resistant to pressure for special discounts than its larger and smaller fellow suppliers - and this applies to its dealings with both corporate chains and other accounts. That suppliers with sales of $20, 000, 000 and over should be highly successful in resisting requests for special discounts and allowances from both the major chains and other accounts is not surprising. What is surprising is that the line between suppliers in this sub-group and those in the sub-group just below it in size, should be so sharply drawn. Hence, although some sections of the data lend a measure of support to the hypotheses set out at the beginning of this section, no over-all pattern of relationships is apparent which would lend general and conclusive support to them.

## Suppliers Who Did, and Those Who Did Not, Pay Special Discounts and Allowances, By Size of Total Sales

In Table 5-6, the data of Table 5-5 have been broken down as between those suppliers who did, and those who did not,

grant special discounts and allowances. Of the 339 manufacturers included, 68 did not give special discounts or allowances to any of the buyers included in Table 5-6. In an earlier section it was stated that 63 suppliers did not grant special discounts. The difference between the two figures is accounted for by the addition of one firm not granting special discounts, from among the three firms added in the preceding section, and the addition of four firms which gave discounts only to corporate chains other than the seven major chains, a category which has been excluded from the analysis in this and the preceding section.

Column (7) in Table 5-6 shows the percentage which sales to the major chains constituted of total sales to major chains and to accounts other than chains by size of supplier. For the 68 suppliers not paying special discounts, chains' purchases were 17.01 per cent of total purchases by chains and by accounts other than chains, whilst for the 271 suppliers paying special discounts, chains' purchases were 24.27 per cent of those of chains plus those of accounts other than chains, indicating a marked tendency for the major chains to favour discount-paying suppliers in making their purchases.

TABLE 5-6

SALES AND SPECIAL DISCOUNTS AND ALLOWANCES BY SUPPLIERS WHO DID AND DID NOT GRANT SPECIAL DISCOUNTS AND ALLOWANCES

| (1) Sales Volume of Seller | (2) No. of Sellers | (3) Total Sales to 7 Chains and Accounts other than Chains | (4) No. of Sellers that gave Discounts to Neither Category of Buyer | (5) Sales by Sellers in (4) to 7 Chains | (6) Sales by Sellers in (4) to Accounts other than Chains | (7) (5) as Percentage of (6) plus (5) | (8) No. of Sellers that gave Discounts to either one or the other Category of Buyer | (9) Sales by Sellers in (8) to 7 Chains | (10) Discounts by Sellers in (8) to 7 Chains | (11) Sales by Sellers in (8) to Accounts other than Chains | (12) (9) as Percentage of (11) plus (9) | (13) Discounts by Sellers in (8) to Accounts other than Chains | (14) (10) as Percentage of (13) plus (10) |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | $ | | $ | $ | % | | $ | $ | $ | % | $ | % |
| 1. $0-$499,999 | 151 (44.54%) | 27,186,399.06 (4.00%) | 39 (57.35%) | 1,618,889.98 (10.90%) | 4,290,635.07 (5.92%) | 27.40 | 112 (41.33%) | 8,885,949.45 (6.17%) | 213,294.85 (5.82%) | 12,390,924.56 (2.76%) | 41.76 | 144,905.12 (3.55%) | 59.86 |
| 2. $500,000-$999,999 | 58 (17.11%) | 42,133,664.05 (6.19%) | 11 (16.18%) | 1,903,770.85 (12.82%) | 6,101,011.68 (8.42%) | 23.79 | 47 (17.34%) | 8,265,960.14 (5.74%) | 193,859.44 (5.29%) | 25,862,921.38 (5.76%) | 24.23 | 224,750.09 (5.51%) | 46.30 |
| 3. $1,000,000-$1,999,999 | 51 (15.04%) | 69,478,611.40 (10.21%) | 7 (10.29%) | 1,414,268.80 (9.52%) | 7,133,512.60 (9.84%) | 16.55 | 44 (16.24%) | 19,344,227.97 (13.44%) | 446,755.12 (12.20%) | 41,586,602.03 (9.26%) | 31.75 | 312,544.15 (7.66%) | 58.86 |
| 4. $2,000,000-$2,999,999 | 28 (8.26%) | 64,718,334.94 (9.51%) | 5 (7.35%) | 368,776.85 (2.48%) | 9,866,417.21 (13.61%) | 3.60 | 23 (8.49%) | 15,452,415.34 (10.74%) | 541,197.78 (14.77%) | 39,030,725.54 (8.69%) | 28.36 | 567,776.54 (13.92%) | 48.88 |
| 5. $3,000,000-$4,999,999 | 19 (5.60%) | 67,228,454.08 (9.88%) | 2* (2.94%) | 334,234.35 (2.25%) | 5,569,135.33 (7.68%) | 5.66 | 17 (6.27%) | 10,648,600.43 (7.40%) | 227,889.97 (6.22%) | 50,676,483.97 (11.29%) | 17.36 | 654,658.65 (16.05%) | 25.82 |
| 6. $5,000,000-$9,999,999 | 16 (4.72%) | 99,814,284.09 (14.67%) | 3 (4.41%) | 3,038,164.32 (20.45%) | 16,477,403.15 (22.73%) | 15.57 | 13 (4.80%) | 16,776,788.53 (11.66%) | 351,526.27 (9.60%) | 63,521,928.09 (14.15%) | 20.89 | 271,565.24 (6.66%) | 56.43 |
| 7. Over $10,000,000 | 16 (4.72%) | 309,622,014.79 (45.52%) | 1 (1.47%) | 6,177,205.00 (41.58%) | 23,038,574.00 (31.79%) | 21.14 | 15 (5.54%) | 64,539,968.57 (44.85%) | 1,688,855.98 (46.10%) | 215,866,267.22 (48.08%) | 23.02 | 1,902,152.91 (46.64%) | 47.03 |
| 8. TOTALS | 339 (100%) | 680,181,762.41 (100%) | 68 (100%) | 14,855,310.15 (100%) | 72,476,689.04 (100%) | 17.01 | 271 (100%) | 143,913,910.43 (100%) | 3,663,379.41 (100%) | 448,935,852.79 (100%) | 24.27 | 4,078,352.70 (100%) | 47.34 |

*Sellers were classified into sales-size classes on the basis of their total sales. This table includes only sales to the seven major chains and to accounts other than chains, omitting sales to "other corporate accounts". Sales to this last category of buyer account for the failure of firms in this size class to reach the minimum total sales volume that would appear to be required for inclusion in this bracket.

Within the category of non-discount-paying suppliers, the chains' purchases relative to the total for chains and accounts other than chains were above "average" (17.01 per cent) for suppliers in the two smallest size-classes ("1" and "2") and in the largest size-class ("7" - containing only one supplier whose products enjoy a very high degree of consumer acceptance), slightly below the "average" in size-classes "3" and "6", and very much below in size-classes "4" and "5".

Turning to the category of discount-paying suppliers, the chains' purchases as a percentage of the total for chains and accounts other than chains were very far above "average" (24.27 per cent) in the smallest size-class (41.76 per cent), moderately above "average" in size-classes "3" and "4", about "average" in class "2", slightly below in class "7", and more or less substantially below "average" in classes "5" and "6". It should be added that little additional information would be obtained by breaking down the largest size-class ("7") into two sub-groups, as was done in the preceding section, as only one supplier was transferred to the non-discount-paying category. In general, there is a fairly clearly defined tendency for the chains' share of sales to be more or less above "average" for suppliers in the four smaller size-classes and more or less below "average" for those in the three larger size-classes. In view of the strongly established consumer preference of the brands sold by the larger suppliers this differential assumes added significance.

With respect to the rate of special discounts and allowances, there is no significant correlation between the size of the supplier and the level of the rate of discount paid either to chains or to accounts other than chains. The coefficient of rank correlation is low and negative in both cases. In other words, there appears to be no clear tendency for suppliers ranged in the seven sales-size classes of Table 5-6 to pay either larger or smaller rates of special discounts and allowances as their sales-size category increased - and this holds for their sales to both chains and other accounts.

Rank correlation coefficients were also computed to indicate whether there was a tendency for supplier groups making larger proportions of their sales to chains to grant higher rates of special discounts to chains. That is, size-classes of suppliers were ranked on the basis of the share of their sales that went to chains and the corresponding rates of special discounts were likewise

ranked. The same relationship was tested for "other accounts". The difference in the coefficients was marked. In the former case - share of sales taken by chains and rate of discount paid - the coefficient was +.50, whilst in the latter - share of sales taken by other accounts and rate of discount paid - it was - 0.07. Since the 5 per cent level of significance would require a coefficient of 0.75, it is clear that the correlation for chains cannot be taken as indicating any close relationship between the level of the rate of special discounts and the share of sales. At the same time, the correlation is much closer for chains than for other accounts.

ANNEX I

COPY

Room 746, Justice Building,

Re: Inquiry into price differentials as between different classes of buyers

Dear :

I know that you are familiar, in a general way at least, with the inquiry now being conducted by the Combines Branch on the subject of "loss-leader" selling. This inquiry was recommended by the MacQuarrie Committee at the time it recommended the prohibition against resale price maintenance.

During the course of this inquiry it has become evident that some of the selling prices complained about as "loss-leaders" are reflections, in part at least, of better buying prices rather than instances of the sale of goods below or slightly above cost.

For this reason it appears necessary to obtain some information on the differences between the buying prices of different categories of buyers and for this purpose a number of questionnaires to manufacturers, wholesalers and chain stores have been prepared.

I am enclosing the questionnaire directed to chain stores and I would appreciate it very much if you would compile the information indicated thereon and forward it to me.

I realize that this will involve a very considerable amount of work on your part and I regret the necessity of putting you to this trouble. The subject, however, is one of very great current interest and I therefore consider it essential that we know more about it.

The fact that this questionnaire will involve a large amount of work both for you and for us makes it all the more important to ensure that it serves its purpose, and that the labour involved will not be wasted through any lack of clarity on our part or misunderstanding on yours. If, therefore, the questionnaire is not perfectly clear to you, or if you have any reason to believe, after examining it, that it will not bring out the desired information, I would be glad to discuss it with you before you proceed to compile

the material. I might mention, in this respect, that we have already sought to eliminate any "bugs" by discussing it thoroughly with a leading distributor.

If it will require a considerable period of time to put together the complete information on this questionnaire, it would be of substantial assistance to me if you could first compile the list of suppliers requested in paragraph 3.

I am not going to request the return of this information by a specific date, but I would like to have it, if possible, by

Yours very truly,

T. D. MacDonald,
Director

Encl.

ANNEX I

## QUESTIONNAIRE ON SPECIAL DISCOUNTS AND ALLOWANCES

## CHAIN STORES

1. Name of Firm.

2. Address

Please answer the following questions in respect of (a) the calendar year 1953, or (b) your last fiscal year, indicating whether you have selected (a) or (b).

3. List all the suppliers from whom you received any special discount or allowance. Special discounts and allowances are considered to be all those forms of discount and allowance which do not appear on the face of the invoice. In general, it is believed that such special discounts and allowances will include, among others, the following categories:

   (a) advertising, store display or other types of promotional* allowance whether specifically related to purchases or not;

   (b) discounts, rebates or allowances based on total volume of purchases over a given period;

   (c) discounts, rebates or allowances based on an increase in volume of purchases in a given period over a past period;

   (d) brokerage allowances.

The suppliers need not for the purposes of this paragraph be listed separately in categories (a), (b), (c), (d).

4. State the total dollar value at net invoice price** of all merchandise items purchased by your chain store during the period selected, excluding only items of equipment and supply not purchased for resale.

5. State the total dollar amounts of all special discounts and allowances received by your chain store during the period selected; and please provide a breakdown of this total which will show the dollar amounts received for each separate category of discount or allowance.***

6. State the total dollar value at net invoice price** of those merchandise items on which special discounts and allowances were received by your chain during the period selected in question 2, omitting, as in question 4, items of equipment and supply not purchased for resale. This question involves excluding from the total reported in question 4 the dollar value of purchases on which special discounts and allowances were NOT received.

* The term "promotional allowance" is intended to cover any allowance given in consideration of special attention to the sale of a product.

** "Net invoice price" means net price after deduction of all discounts shown on invoice. Cash discount, however, should <u>not</u> be deducted. If you calculate "total dollar value of purchases" on a basis other than net invoice, please indicate.

*** If a different grouping of types of special discounts and allowances from that suggested in question 3 is more convenient, please provide the breakdown requested on the basis of your own classification of special discounts and allowances.

# ANNEX II

Re: Inquiry into price differentials as
between different classes of buyers

I know that you are familiar, in a general way at least, with the inquiry that was conducted by the Combines Branch on the subject of "loss-leader" selling. This inquiry was recommended by the MacQuarrie Committee at the time it recommended the prohibition against resale price maintenance.

During the course of this inquiry it became evident that some of the selling prices complained about as "loss-leaders" were reflections, in part at least, of better buying prices rather that instances of the sale of goods below or slightly above cost.

For this reason it appears necessary to obtain some information on the differences between the buying prices of different categories of buyers and for this purpose a number of questionnaires to manufacturers, wholesalers and chain stores have been prepared.

I am enclosing a questionnaire directed to suppliers and I would appreciate it very much if you would compile the information indicated thereon and forward it to me.

I realize that this will involve a very considerable amount of work on your part and I regret the necessity of putting you to this trouble. The subject, however, is one of very great current interest and I therefore consider it essential that we know more about it.

The fact that this questionnaire will involve a large amount of work both for you and for us makes it all the more important to ensure that it serves its purpose, and that the labour involved will not be wasted through any lack of clarity on our part or misunderstanding on yours. If, therefore, the questionnaire is not perfectly clear to you, or if you have any reason to believe, after examining it, that it will not bring out the desired information, I would be glad to discuss it with you before you proceed to compile the material. I might mention, in this respect, that we have already sought to eliminate any "bugs" by discussing it thoroughly with a leading manufacturer.

I am not going to request the return of this information by a specific date, but I would like to have it, if possible by

Yours very truly,

T. D. MacDonald,
Director

Encl.

## ANNEX II

## QUESTIONNAIRE ON SPECIAL DISCOUNTS AND ALLOWANCES - SUPPLIERS

1. Name of firm

2. Address

3. Please answer the following questions in respect of (a) the calendar year 1953, or (b) your last fiscal year, indicating whether you have selected (a) or (b).

4. For each of the buyers and categories of buyers listed in questions 5, 6, 7 and 8, please provide the following information for the period indicated in question 3:

   (a) Total sales value* of finished goods sold in the domestic market.

   (b) Total amount of special discounts and allowances granted by your firm on the goods mentioned in (a) broken down so as to show each kind of such discount or allowance and the sales value of the goods to which it applied. A discount or allowance which cannot be identified with any particular goods should be treated as applying to the customers' total purchases.

   Special discounts and allowances are considered to be all those forms of discount and allowance which do not appear on the face of the invoice. In general, it is believed that such special discounts and allowances will include, among others, the following categories:

   (a) advertising, store display or other types of promotional** allowance whether specifically related to purchases or not;

   (b) discounts, rebates or allowances based on a total volume of purchases over a given period;

   (c) discounts, rebates or allowances based on an increase in volume of purchases in a given

period over a past period;

(d) brokerage allowances.

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* If you calculate this total on a basis other than net invoice price, please indicate.

** The term "promotional allowance" is intended to cover any allowance given in consideration of special attention to the sale of a product.

5. (a) Large corporate chains

Canada Safeway Limited, Winnipeg, Man.

Dominion Stores Ltd., 605 Rogers Road, Toronto, Ont.

The O.K. Economy Stores, 301 Ontario Avenue, Saskatoon, Sask.

The Great A. & P. Tea Co. Ltd., 135 Laughton Avenue, Toronto, Ont.

Loblaw Groceterias Co. Ltd., Fleet & Bathurst Streets, Toronto, Ont.

Steinberg's Wholesale Groceterias Ltd., 5400 Hochelaga Street, Montreal, P.Q.

Thrift Stores Ltd., 960 Outremont Avenue, Montreal, P.Q.

(b) All other corporate chain stores, reported as a group.*

6. (a) Grocery and Drug Wholesalers

Kelly, Douglas & Co. Ltd., 3700 Kingsway, Burnaby, Vancouver, B.C.

Macdonalds Consolidated Ltd., 313 Pacific, Winnipeg, Man.

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* By a "corporate chain store" is meant a retail organization under a single management operating four or more retail outlets.

Macdonalds Consolidated Ltd., 840 Cambie, Vancouver, B.C.

The W. H. Malkin Co. Ltd., 57 Water, Vancouver, B.C.

J. M. Sinclair Limited, Princess & Bannatyne, Winnipeg, Man.

Western Grocers Ltd., 289 King, Winnipeg, Man.

Merchants Distributors Ltd., Fort William, Ont.

Gamble-Robinson Ltd., 105 King Street East, Toronto, Ont.

National Grocers Co. Ltd., 21 Front Street East, Toronto, Ont.

York Trading Ltd., Toronto, Ont.

Atlantic Wholesalers Ltd., Sackville, N.B.

Drug Trading Co., Ltd., 15 Ontario Street, Toronto, Ont.

Coopérative Fédérée, Montréal, P.Q.

Shelley Bros., Cor. Ontario Avenue and 24th, Saskatoon, Sask.

Kingston Suppliers, Vancouver, B.C.

(b) All other grocery wholesalers reported as a group.

7. (a) Voluntary chain groups**

Independent Grocers Alliance, 490 Industrial, Ottawa, Ont.

Les Magasins "Regal" Stores, Inc., Three Rivers, P.Q.

(b) All other voluntary chain groups reported as a group.

8. All other accounts.

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** For purposes of this questionnaire a "voluntary chain group" is a group of four or more independent retail outlets buying into a central warehouse.

## CHAPTER VI

# PRICES TO CORPORATE CHAINS, WHOLESALERS, AND INDEPENDENTS, METROPOLITAN TORONTO AREA

The preceding analyses of discount structures and of special discounts and allowances have indicated something of the extent of the differentials that apply to different categories of buyers, the degree of precision being much greater, in the nature of the data, for special discounts and allowances than for discount structures. In order to obtain for a limited market area as close a comparison as was feasible of actual net terms to a number of buyers, a special survey was undertaken applying to a group of grocery products delivered to warehouses in the metropolitan Toronto area. The questionnaire on which this survey was based and the covering letter are attached to this chapter as Annex I.

The survey covered a list, after deletions,[1] of 221 grocery items which had been selected, in connection with another survey undertaken by the Director, by a group of retailers as being representative grocery-store products with a high rate of turn-over. The group of buyers was selected so as to include both large and relatively small firms in the chain store and wholesale grocery fields. In the former, the firms were:

Dominion Stores Limited,
The Great Atlantic & Pacific Tea Company Limited,
Loblaw Groceterias Co., Limited,
Power Super Markets Limited,
Bassin's Food Markets.

In the latter:

Gamble-Robinson Limited,
National Grocers Company Limited,
Higgins & Burke Ltd.

A questionnaire was sent to the manufacturer (or distributor) of each of the 221 grocery products, requesting information on the following terms on which the grocery item in question was sold to each of the above firms to which the manufacturer made sales, on the nearest possible date to August 15, 1954, for delivery to warehouses in metropolitan Toronto:

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1. Some items were deleted from the original list because a price change had taken place during the period covered by the quotations to the various buyers listed.

(a) the net invoice price (before deducting cash discount),

(b) the special discounts and allowances applying to the sale. (See the annexed copy of the questionnaire for the detailed definition of these terms.)

Prices were quoted by all suppliers in terms of the customary unit in which sales were made, that is, "per dozen", "per case", and so on. No attempt was made to translate these prices into single-unit prices. Totals were calculated for each buyer showing (1) "net invoice price" for all the items reported as sold to him; (2) the "net price", which is the "net invoice price" less any special discounts and allowances; and, finally, the percentage which the difference between these two totals bore to the total of the "net invoice prices".

Purchases from a Total of 221 Items

| Buyer | (1) Total at Net Invoice Price $ | (2) Total at Net Price $ | (3) (1) - (2) Spec. Discs. & Allows. $ | (4)[1] (3) as a % of (1) % |
|---|---|---|---|---|
| Chains | | | | |
| A. .......... | 994.81 | 978.16 | 16.65 | 1.67 |
| B. .......... | 940.85 | 926.78 | 14.07 | 1.49 |
| C. .......... | 922.03 | 905.41 | 16.62 | 1.80 |
| D. .......... | 804.14 | 796.54 | 7.60 | 0.95 |
| E. .......... | 584.57 | 579.34 | 5.23 | 0.89 |
| Wholesalers | | | | |
| AA. .......... | 308.79 | 303.63 | 5.16 | 1.67 |
| BB. .......... | 849.04 | 837.74 | 11.30 | 1.33 |
| CC. .......... | 684.32 | 675.61 | 8.71 | 1.27 |

1. Where comparisons for individual chains can be made, special discounts and allowances as a percent of purchases in this table tend to run almost one-third less than the percentages for the same chains reported in Table 5-3, p. 124 . Since the sellers of the "representative" products are among the largest suppliers, a differential in this direction - although not necessarily of this magnitude - might have been expected.

Turning to the wholesalers, one of those for which a comparison can be made, obtains a slightly better rate of special discounts and allowances as a percent of sales for the "representative" items than for the broader group reported in Table 5-4, p. 129 , and one obtains a slightly lower rate.

It is clear that the suppliers of the "representative" products accord to at least the larger chains and wholesalers more nearly equal treatment with respect to special discounts and allowances than do the suppliers covered in the general survey.

The totals in this table apply to numbers of items that vary from buyer to buyer, hence the absolute figures cannot be compared; however, the percentage which special discounts and allowances constitute of the total net invoice price is of some interest. Among the chain stores, the largest percentage rate was received by the firm with the largest volume of sales, (the order of sales volume, it should be noted, does not follow the order of the totals at net invoice prices) and successively lower rates were received by firms that followed one another in size. The minimum percentage was almost exactly half the maximum percentage, the difference amounting to 9/10ths of 1 percentage point, which, in the grocery field, is a substantial differential.

Among the wholesale grocers, the relationship noted between percentage rate of special discounts and allowances and volume of sales of grocery products for the chain stores does not hold. The highest percentage rate of special discounts and allowances was received by the wholesaler with the smallest sales volume of dry groceries, although this rate was below the maximum received by chain stores (1.67% against 1.80%). The wholesaler with the largest volume of sales obtained the next highest percentage rate of special discounts and allowances, which was considerably lower than the second highest rate obtained by the chains (1.33% against 1.67%). The rate earned by the remaining wholesaler was only slightly lower than that received by the largest wholesaler and moderately lower than that received by the chain in third position (1.27% against 1.49%).

In order to provide a basis for a more precise comparison in which net invoice prices as well as special discounts and allowances related to the same items, a compilation was prepared of those grocery products which were purchased by all eight of the firms listed in the questionnaire. There were only 43 such items out of the total of 221 items covered in the survey.[1]

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1. This appears, on first glance, to be a relatively small proportion of a group of "representative grocery-store products with a high rate of turnover" to be purchased by all eight of the buyers listed. Two factors appear to be important in explaining this result. First, the items were listed as specific brands in specific sizes. Hence a buyer might purchase the product in question but in only one of two sizes listed. Second, one buyer in particular did a relatively small volume in dry groceries and this volume was limited to a restricted number of lines of grocery products.

43 Items Purchased by All Buyers

| Buyer | (1) Total at Net Invoice Price $ | (2) Total at Net Price $ | (3) (1) - (2) Spec. Discs. & Allows. $ | (4)[1] (3) as a % of (1) % |
|---|---|---|---|---|
| Chains | | | | |
| A | 229.41 | 222.80 | 6.61 | 2.88 |
| B | 229.21 | 224.13 | 5.08 | 2.21 |
| C | 229.21 | 223.35 | 5.86 | 2.55 |
| D | 229.21 | 224.51 | 4.70 | 2.05 |
| E | 229.21 | 226.43 | 2.78 | 1.21 |
| Wholesalers | | | | |
| AA | 229.21 | 224.81 | 4.40 | 1.91 |
| BB | 229.21 | 224.12 | 5.09 | 2.22 |
| CC | 229.21 | 224.95 | 4.26 | 1.85 |

There are a number of points of interest in this table:

(1) The total net invoice price of the 43 items is almost identical for each of the eight buyers. Chain store "A" was charged a slightly higher net invoice price for one item than the other buyers but this was offset by a compensating increase in special discounts and allowances so that all three of the largest chains were charged the same net price for this item.

(2) The average level of special discounts and allowances as a percentage of net invoice price is very substantially higher for these 43 items than for the total number of items (out of the 221 included) purchased by each of the eight buyers. The maximum percentage for chain stores shown in the present case is 2.88 per cent compared with 1.80 per cent in the previous case, and this maximum was not received by the

1. It will be noted that special discounts and allowances as a percent of sales are much higher for this group of 43 items than for the larger groups of items reported on pp. 154 and 158. This is due to the fact that the 16 items carrying the highest rates of special discounts and allowances in the entire array of 221 items were found in the group of 43 items purchased by all buyers. Maximum rates of special discounts and allowances for these 16 items ranged from 3 1/3 per cent to 9 per cent. These items were found in the following product groups: biscuit products, paper toilet products and cereal products.

same firm in both instances; the minimum percentage for the same group, which was received by the same firm in both instances, increased less than one-third as much as the maximum, rising from 0.89 per cent in the previous case to 1.21 per cent in the present case. Among wholesalers, the maximum percentage in the present case is 2.22 per cent as compared with the maximum, received by a different firm, of 1.67 per cent in the previous case, and this increase was approximately one-half of that shown by the chains' maximum percentage; the minimum percentage for wholesalers, received by the same firm in both instances, rose from 1.27 per cent in the previous case to 1.85 per cent in the present case, which gave it a greater increase than that shown by the minimum percentage for chains.

(3) The maximum percentage which special discounts and allowances bore to the total of net invoice prices for chains was received, not by the largest chain, but by the second largest; apart from this change of position of the two leading chains, the same relationship between size of chain and percentage magnitude held in this case as in the previous one - namely, the smaller the chain the smaller the percentage rate received. For wholesalers, the largest firm did receive the maximum percentage rate of special discounts and allowances in the present case, whereas it stood in second position in the previous case; following it, the smallest wholesaler received the second largest percentage rate, and the second largest of the three received the lowest rate.

(4) The maxima for chains and wholesalers in the present case stand at 2.88 per cent and 2.22 per cent, respectively, as compared with 1.80 per cent and 1.67 per cent in the previous case; and the minima at 1.21 per cent (chains) and 1.85 per cent (wholesalers) in the present case, as compared with 0.89 per cent and 1.27 per cent in the previous case. The spread has widened for both sets of values in the present case: for the maximum, favourably to the chain; for the minimum, favourably to the wholesaler.

Although the sample of 43 items provides a more or less satisfactory base for the computations that have been made, a broader base can be provided by eliminating from our list of firms the chain store and the wholesaler that purchased the smallest number of items. With the list of buyers thus limited to six, there were 103 items that were purchased by each. The following table sets out the data for this

group of grocery products on the same basis as that employed in the preceding analyses.

103 Items Purchased by Each of Six Buyers

| Buyer | (1) Total at Net Invoice Price $ | (2) Total at Net Price $ | (3) (1) - (2) Spec. Discs. & Allows. $ | (4) (3) as a % of (1) % |
|---|---|---|---|---|
| Chains | | | | |
| A | 550.78 | 541.50 | 9.28 | 1.69 |
| B | 550.58 | 542.61 | 7.97 | 1.45 |
| C | 550.43 | 540.75 | 9.68 | 1.76 |
| D | 550.16 | 544.31 | 5.85 | 1.06 |
| Wholesalers | | | | |
| AA | 549.90 | 543.39 | 6.51 | 1.18 |
| BB | 549.65 | 542.37 | 7.28 | 1.33 |

The data in the table are largely self-explanatory but a few comments may call attention more quickly to some of the highlights:

(1) The net invoice price for the 103 items is slightly lower for wholesalers than for chains; this condition is traceable to the fact that a few items were sold on a trade discount basis which gave better terms to wholesalers than to chains. Within each category of buyer, it is also worth noting that the lowest net invoice price was obtained by the smallest firm, although the differentials involved were very small.

(2) The average level of special discounts and allowances was substantially below that on the 43 items purchased by all eight buyers but it was approximately of the same order of magnitude as applied to the over-all purchases in the group of 221 items.

(3) The net price of the 103 items was lowest for the largest chain store and this figure increased as the chains became smaller. The lower of the two total net prices for wholesalers was that paid by the smaller firm. In order of their position with respect to "net prices" in the group of six, the wholesalers occupied third and fifth positions, with the largest and second-largest chains occupying first and second positions.

Comment

It was pointed out in an earlier section that some discount structures provided the basis for quite considerable differentials in prices as between the large and the small buyer. The eight buyers in the present survey cover a substantial range in size, with the largest chain and wholesaler having sales thirty to forty times as great as the smallest firm. However, despite these size differences, net invoice prices for the two groups of products which were purchased by each of the eight buyers, or the six buyers, were virtually uniform. It is true, of course, that the "small" buyers are small only in a relative sense and that in absolute terms they are still firms of some substance. Nevertheless, there is nothing to suggest that the minimum size of the firms surveyed is unreasonably large in view of the scale requirements of an efficient, present-day system of grocery distribution.

Hence, it seems fair to say that the information on net invoice prices discloses no evidence of significant differentials as between chain stores and wholesalers or as between larger and smaller firms in each of these categories of distributor. Differential treatment arises almost entirely from differences in rates of payment for special discounts and allowances. With respect to the actual differences in percentages paid to different buyers, it is clear that in the context of the size of the gross and net operating margins prevailing in chain store and wholesale grocery distribution, such differences as prevailed between the large and small chains and the large chains and the wholesalers could be of substantial importance. It has been pointed out in the sections on "the big buyer" and the economic aspects of price discrimination, that a wide range of considerations is involved in an evaluation of the impact and significance of such price differentials and that analysis is likely to be most fruitful if carried out on a case by case basis.

## Prices to Corporate Chain Units and Independent Grocery Retailers, Metropolitan Toronto Area

The preceding section dealt with a survey of buying terms to certain chain stores and grocery wholesalers in the metropolitan Toronto area for a group of representative grocery products delivered to warehouses. A further survey was undertaken of the buying terms applying to a group of grocery products which were delivered to the individual units of chain stores and to the stores of independent grocery retailers. The types of products included were: bread, biscuits, shortening, tea, coffee, cereals, flour mixes, and salad dressing. Prices for a few products were rejected because a price change had taken place during the period covered by the quotations to the various buyers listed. The number of items on which prices were obtained for all groups covered was seventeen.

The manufacturer (or distributor) of each of these items was sent a questionnaire requesting data on (1) the net invoice price, and (2) the special discounts and allowance applying to the item in question, for each of the buyers listed in the questionnaire for the sale made on the nearest possible date to November 15, 1954. (See the copy of the questionnaire and covering letter which are attached to this chapter as Annex II for the detailed definition of the terms "net invoice price" and "special discounts and allowances".) The buyers were broken down into four groups:

Major Chains

Dominion Stores Limited
The Great Atlantic & Pacific Tea Company Limited
Loblaw Groceterias Co., Limited

Secondary Chains

Power Super Markets Limited
Bassin's Food Markets
Carload Groceterias

Voluntary Groups

I.G.A. Food Stores

Independent Grocers

Forty-nine grocers distributed throughout the metropolitan Toronto area selected because they were among the largest "independents" in size and were in fairly close proximity to one or another of the units of the major chains.

The number of items priced for I.G.A. Food Stores was so limited that this category of buyer has been omitted from the report.

Net Invoice Prices

Total net invoice prices for the seventeen items for each of the three groups of buyers are reported in the following table. The "average net invoice price" is computed on the basis of "one reported buyer one price", without attempting to weight the price by the volume of purchases made by each buyer. The "maximum net invoice price" is the highest net invoice price shown for any buyer in the group, and the "minimum net invoice price" is the lowest net invoice price shown for any buyer in the group.

Totals of Net Invoice Prices for 17 Grocery Products

| | Average Net Invoice Price $ | Max. Net Invoice Price $ | Min. Net Invoice Price $ |
|---|---|---|---|
| Major Chains | 41.630 (100%) | 41.633 (100%) | 41.629 (100%) |
| Secondary Chains | 42.051 (101.01%) | 42.470 (102.01%) | 41.814 (100.44%) |
| Independents | 43.414 (104.28%) | 44.203 (106.17%) | 42.885 (103.02%) |

It will be recalled that the net invoice prices to various chains and wholesalers in the Toronto area, reported in the preceding section, were almost identical. The same condition does not hold for the distributors covered in the present survey. The total of "average net invoice prices" was at a minimum for purchases by the major chains, was only slightly higher for the secondary chains, but was, in terms of margins in this field, substantially higher for the independent grocers (4.28%). The totals at "maximum net invoice prices" showed a considerably wider spread, as is indicated in the table; and the totals at "minimum net invoice prices" show a somewhat narrower spread between the major chains through the independent grocers than was the case for either average or maximum invoice prices.

The secondary chains bought three items at the same minimum price as the major chains; they bought no item at a lower price than the majors. One of the three items was bought by all three of the secondary chains at the same minimum as the majors; one was bought by two of the secondary chains (the only two buying it) at the same minimum as the majors; and one item was bought by a single secondary (of the three buying it) at the same minimum as the major chains.

The independents bought two items at the same minimum price as the major chains; they bought no item at a lower price than the majors. One item was bought by two independents (of the 12 buying it) at the same minimum price as the major chains; and one item was bought by 40 independents (out of 45 buying it) at the same minimum price as the major chains.

For the major chains the totals at maximum and minimum net invoice prices are virtually the same - the difference amounts to only 4/10ths of a cent; in other words, all three chains bought at almost the same minimum net invoice price. The secondary chains

showed a difference of $0.656 - about 1.5 per cent - between the totals at maximum and minimum invoice prices; whilst the independents showed a spread almost twice as great - $1.318, or about 3 per cent.

The number of items on which special discounts and allowances were paid varied greatly from one category of buyer to the next: the major chains received such payments on 12 of the 17 items listed; the secondary chains on one item; and the independents on four items. The items on which the two latter groups of buyers received special discounts and allowances were included in the 12 items on which the major chains received such payments.

If, after adjusting the prices of all items to take account of special discounts and allowances, new total minimum net prices for the 17 items were computed for each category of buyer, these totals would be as follows:

| | |
|---|---|
| Major chains | $40.273 (100%) |
| Secondary chains | 41.808 (103.81%) |
| Independents | 42.854 (106.41%) |

If totals were limited to the 12 items on which special discounts and allowances were received by one or another of the different groups of buyers, the minimum total at which the 12 items could be purchased by some or all of the members of the different categories of buyer, would be:

| | |
|---|---|
| Major chains | $35.434 (100%) |
| Secondary chains | 36.899 (104.13%) |
| Independents | 37.814 (106.72%) |

The percentage differentials as between different categories of buyer differ very little in the case of the 12 products from what they were for the 17 products. If a comparison is made between the totals for the 17 products at minimum net invoice prices and at minimum net prices, it is apparent that slightly less than one-half of the total price differential between "major chains" and "independents" at minimum net prices is attributable to differences in invoice prices and slightly more than half to special discounts and allowances. If the differential between "major chains" and "secondary chains" is examined on the same basis, it appears that only about 12 per cent of the total price differential is attributable to differences in invoice prices and the remainder, 88 per cent, is due to differences in special discounts and allowances.

The differentials, both at net invoice prices and at net prices, between the major chains and the "independents" must, in view of the margins in this field, be considered to be very large. The differentials at net invoice prices between the major chains and the

secondary chains are small, but at net prices they are quite substantial, as are the differentials between the secondary chains and the "independents" at both net invoice and net prices.

Although the grocery items on which the survey was based were delivered to the individual units of chains as well as to the independent grocer, there were certain aspects of their distribution which were not identical. The billing and payment of accounts in the case of the chain store are handled through the head office for all units, whilst individual billing and collection are necessary for the independents; it is also claimed that the sales expense involved in making a single sale to the chain store buyer is much less than that involved in making sales to a number of independents for an equivalent volume of the product. The difference in this latter respect may not be as great as at first appears since the amounts shipped from week to week to the individual units of the chain usually are the subject of separate orders from each unit to the supplier.

Although these cost elements are of some importance, the economic analysis of price differentials requires, as has already been suggested, consideration of a broad range of factors outlined in earlier sections of this survey.

## ANNEX I

Re: Inquiry into price differentials as between different classes of buyers

I know that you are familiar, in a general way at least, with the inquiry now being conducted by the Combines Branch on the subject of "loss-leader" selling. This inquiry was recommended by the MacQuarrie Committee at the time it recommended the prohibition against resale price maintenance.

During the course of this inquiry it has become evident that some of the selling prices complained about as "loss-leaders" are reflections, in part at least, of better buying prices rather than instances of the sale of goods below or slightly above cost.

For this reason it appears necessary to obtain some information on the differences between the buying prices of different categories of buyers and for this purpose a number of questionnaires to manufacturers, wholesalers and chain stores have been prepared.

I am enclosing the two[1] questionnaires directed to manufacturers and I would appreciate it very much if you would compile the information indicated thereon and forward it to me.

I realize that this will involve a very considerable amount of work on your part and I regret the necessity of putting you to this trouble. The subject, however, is one of very great current interest and I therefore consider it essential that we know more about it.

The fact that these questionnaires will involve a large amount of work both for you and for us makes it all the more important to ensure that they serve their purpose, and that the labour involved will not be wasted through any lack of clarity on our part or misunderstanding on yours. If, therefore, the questionnaires are not perfectly clear to you, or if you have any reason to believe, after examining them, that they will not bring out the desired information, I would be

1. The second questionnaire referred to is on pages 149 - 151.

glad to discuss them with you before you proceed to compile the material. I might mention, in this respect, that we have already sought to eliminate any "bugs" by discussing them throughly with a leading manufacturer.

I am not going to request the return of this information by a specific date, but I would like to have it, if possible, by

Yours very truly,

T. D. MacDonald,
Director

Encls.

## ANNEX I

### Questionnaire on

### Prices to Corporate Chain Grocery Stores

### and Grocery Wholesalers

### Metropolitan Toronto Area,

### August, 1954

(Suppliers)

1. Name of firm

2. Address

3. For each of the firms listed in question 6 to which you make sales, please list the net invoice price* charged for each item listed in question 7 for the sale made on the nearest possible date to August 15, 1954 for delivery to warehouses in Metropolitan Toronto.

4. For each of the firms listed in question 6 to which you make sales, and for each item listed in question 7, please list the total special discounts and allowances granted and the total sales** in respect of (a) the calendar year 1953, or (b) your last fiscal year, indicating whether you have selected (a) or (b).

   Special discounts and allowances are considered to be all those forms of discount or allowance which do not appear on the face of the invoice. In general, it is believed that such special discounts and allowances will include, among others, the following categories:

   (a) advertising, store display or other types of promotional*** allowance whether specifically related to purchases or not;

   (b) discounts, rebates or allowances based on total volume of purchases over a given period;

   (c) discounts, rebates or allowances based on an increase in volume of purchases in a given period over a past period;

(d) brokerage allowance.

* "Net invoice price" means net price after deduction of all discounts shown on invoice as applicable to the specific item and after deduction _pro rata_ of any discount shown on invoice as applicable to several or all items. Cash discount, however, should _not_ be deducted.

** If you calculate "total sales" on a basis other than net invoice, please indicate.

*** The term "promotional allowance" is intended to cover any allowance given in consideration of special attention to the sale of a product.

If your special discounts and allowances are not computed on the basis of the sales of the individual item(s) listed in question 7 but on the basis of sales of a larger group of items, please provide the information requested in question 4 for the _group_ of products and list the individual items that are included and the total sales* value of the group of products. If your special discounts and allowances are, furthermore, not computed on the basis of sales to the Toronto divisions of the firms listed but on the basis of sales to the firm in all locations, please list the information requested in question 4 for total sales to the firm in question.

5. Paragraphs 3 and 4 are intended to bring out the complete pricing picture in connection with each item listed in question 7. If any such item is the subject of any other trade concession whatsoever which is not brought out by these questions, or if any such item enters in any way into the determination of a trade concession not brought out by these questions, please specify.

6. _List of buyers:_

7. _List of items:_

* If you calculate "total sales" on a basis other than net invoice, please indicate.

# ANNEX II

Re: Inquiry into price differentials as between different classes of buyers

Some months ago, I sent you two questionnaires which you were kind enough to complete for me. I now find it necessary to send you a third which covers the remaining aspect of the matter, relating to sales direct to independent stores and to units of chain stores.

You will note that this questionnaire applies only in the event that you distribute the item shown on the questionnaire to the individual units of corporate chains and to separate independent retailers; in other words, it applies to sales which are closely comparable in respect of the services of delivery, sales solicitation and the like. If the services which accompany the sale are substantially alike but differ in one or two minor respects, it would be useful to have the points of difference set out explicitly.

You will also note that your return of special discounts and allowances, in reply to this third questionnaire, may already be included in your return to one of the previous questionnaires, but not in such a manner as to permit us, ourselves, to segregate it.

Again, as in my earlier letter, I wish to emphasize that, in view of the large amount of work involved in preparing the material and later, in compiling and analysing it, it is highly important that the questions asked should be clear to you and should provide us with the information we desire. I would, therefore, appreciate it if you would write me about any points that are not clear to you or which you think could be changed in such a way as to throw more light on the matter under consideration.

I am not going to request the return of this information by a specific date, but I would like to have it, if possible, by

I will appreciate very much your further co-operation in completing this questionnaire.

Yours very truly,

T. D. MacDonald,
Director

Encl.

# ANNEX II

## Questionnaire on Prices to Corporate Chain Grocery Stores and Independent Grocery Retailers, Metropolitan Toronto Area

## November, 1954

(Suppliers)

1. Name of firm

2. Address

3. For each of the firms listed in question 6 to which you make sales on the basis of delivery to the individual units of the corporate chains and to the separate independent retailers, please list the net invoice price* charged for each item listed in question 7 for the sale made on the nearest possible date to November 15, 1954 for delivery in metropolitan Toronto.

4. For each of the firms listed in question 6 to which you make sales on the basis mentioned in question 3, and for each item listed in question 7, please list the total special discounts and allowances granted and the total sales** in respect of (a) the calendar year 1953, or (b) your last fiscal year, indicating whether you have selected (a) or (b).

   Special discounts and allowances are considered to be all those forms of discount or allowance which do not appear on the face of the invoice. In general, it is believed that such special discounts and allowances will include, among others, the following categories:

   (a) advertising, store display or other types of promotional*** allowance whether specifically related to purchases or not;

   (b) discounts, rebates or allowances based on total volume of purchases over a given period;

   (c) discounts, rebates or allowances based on an increase in volume of purchases in a given period over a past period;

(d) brokerage allowance.

---

* "Net invoice price" means net price after deduction of all discounts shown on invoice as applicable to the specific item and after deduction pro rata of any discount shown on invoice as applicable to several or all items. Cash discount, however, should not be deducted.

** If you calculate "total sales" on a basis other than net invoice, please indicate.

*** The term "promotional allowance" is intended to cover any allowance given in consideration of special attention to the sale of a product.

If your special discounts and allowances are not computed on the basis of the sales of the individual item(s) listed in question 7 but on the basis of sales of a larger group of items, please provide the information requested in question 4 for the group of products and list the individual items that are included and the total sales* value of the group of products. If your special discounts and allowances are, furthermore, not computed on the basis of sales to the Toronto divisions of the firms listed but on the basis of sales to the firm in all locations, please list the information requested in question 4 for total sales to the firm in question.

5. Paragraphs 3 and 4 are intended to bring out the complete pricing picture in connection with each item listed in question 7 to the types of accounts mentioned. If any such item is the subject of any other trade concession whatsoever which is not brought out by these questions, or if any such item enters in any way into the determination of a trade concession not brought out by these questions, please specify.

6. List of buyers:

7. List of items:

---

* If you calculate "total sales" on a basis other than net invoice, please indicate.

## CHAPTER VII

# THE NATURE, SIZE AND LEGAL STATUS OF CERTAIN SPECIAL DISCOUNTS AND ALLOWANCE PAYMENTS

### Review of Individual Replies to the "Questionnaire on Special Discounts and Allowances - Suppliers"

In letters accompanying replies to the detailed sections of the "Questionnaire on Special Discounts and Allowances", a number of suppliers described the "trade deals" for which they were making promotional payments to distributors, set out the conditions under which such deals were made, or commented more generally upon the nature and significance of this comparatively recent development in merchandising. No attempt was made to obtain a complete catalogue of the arrangements for special discounts and allowances employed by the suppliers covered in this survey. In part, because the formal arrangements were frequently reported as being little more than the basis for negotiation; in part, because a statement of the terms on which special discounts and allowances would be paid provides - especially where "performance" satisfactory to the supplier was required - no reliable guide to the degree to which different buyers were able, in practice, to qualify for payments. Hence the following excerpts deal with general aspects and tendencies of promotional arrangements rather than with the detailed analysis of a number of individual schemes. A few suppliers, either by letter or interview, also raised questions as to the legal status of their arrangements for special discounts and allowances and this matter is dealt with in the third section of this chapter.

### The Nature of the Arrangements for which Special Discounts and Allowances are Paid

With only one or two exceptions, the suppliers covered in the present survey stated that it was impossible to provide a breakdown showing payments made for each kind of special discount and allowance listed in the questionnaire. The majority provided only some general heading such as "promotional allowances", "advertising payments", and the like; a limited number provided some further description of the arrangements with their buyers and of the conditions on which promotional payments were made.

First, it appears that advertising and promotional deals are preferred by some buyers to other methods of receiving special terms on their purchases. One supplier remarked with reference to a major chain store:

"Although we don't extend any quantity discount to this organization, we do participate in radio programs, cooking schools, store displays, and other promotional ideas - the cost of which we pay. This organization prefers this type of sales promotion."

The same supplier made the following comment about its arrangements with another major chain store:

"We have an advertising arrangement with ["X"] whereby they feature our products in their newspaper price advertisements each month, for which we agree to pay a maximum of $100.00 per month. This firm has requested this type of advertising arrangement rather than a percentage quantity discount."

In certain other cases, although it was clear that special discounts and allowances took the form of specific promotional deals, there was nothing to indicate whether it was the buyer or the supplier who preferred to relate the payment of allowances to the performance of specific services rather than directly to the sale of goods. The following comments are typical:

"The allowances indicated on the attached report with respect to certain large organizations are the purchase on our part of specific services of an advertising or promotional nature which these operators are in a position to provide, whereby we supplement our own consumer advertising via newspapers, radio, etc."

\- - -

"The promotional money spent with these customers covered newspaper advertising, floor displays, window banners, bulletins to store managers, with the rate of payment being established by mutual agreement for the varying types of services rendered."

\- - -

". . . in order to promote the sale of our product, we are permitted demonstration space which is charged to us as space rental under contract and which we pay out as such."

Very frequently, suppliers reported specifically that the payments made to buyers were "unrelated to sales"; in other cases, they listed examples of the type of arrangement for which payment was

made, some of which did, and some of which did not, appear to be related to the amounts of goods purchased.

The following description of its promotional arrangements with one chain store was provided by a supplier:

> "6 newspaper ads, promotional features, etc. 2 new store openings, free samples, etc.
>
> June Promotion and Advertising Circular. Goods for new store opening . . . . Promotional allowance of 50¢ doz. on 1500 doz. ["Y" product] for end counter display, newspaper ads, etc., and special feature resale price."

Another supplier provided this review of his arrangements with certain buyers:

> "$562.50 for an ad in their monthly catalogue.
> $450 for cooperative advertising in newspapers and circulars:
> 6 months at $75 per month.
> $100.00 worth of goods for distribution of bags of groceries at a party of employees.
> $250 for a monthly cooperative ad in newspapers."

Another supplier had this arrangement with a buyer:

> "We rented space in their store and paid demonstrators to distribute samples of our product. This demonstration ran for approximately two weeks and cost a total of $158.80. In addition to this, we paid ["X"] $50.00 a month for six months to feature ["Y" product] in their newspaper advertisements each week."

A supplier reported on his arrangement with one buyer as follows:

> "Unrelated to sales. Covered cost of 13,941 multi-coloured shopping cart-cards @ 10¢ per card, which also included newspaper advertising in 43 Ontario newspapers and end displays in 170 stores.
>
> 15¢ per dozen Promotional Allowance on 800 dozen ["Y" product], in return for featuring and shelf display."

A supplier described its general policy in the following terms:

> "With one independent or with one chain organization, such promotions are of their own creation where they approach us with a proposition on which they have set a price outlining the value offered in the form of special displays, type of newspaper support being given, and any special features they believe of value. We appraise their proposition, and if we consider the promotional effort worth the price, we buy it; if not, we simply refuse as we can better use such money in our own normal advertising efforts."

Another supplier reported a generally similar arrangement, with emphasis on proof of performance:

> "We enter into written advertising agreements with any retailer or wholesaler who is willing to advertise the sale of our products. Payment for advertising is not made until proof is received. The agreement entered into as to the amount paid to the advertiser is dependent upon the media used, and the total coverage and frequency."

The policy of another supplier was summed up as follows:

> "["X"] contributes to advertising only where it believes that an advertisement will be sufficiently advantageous to the firm. Tear sheets are required for all agreed advertising and in no case is a flat payment made. ["X"] had been approached from time to time by the large retailing organizations who asked that a flat payment be made for 'advertising services'."

In other cases, although allowances were not related to sales, no effort was, apparently, made to require that the allowances be "earned" by services performed. The following is a case in point:

> "These allowances were given to assist them in promoting and advertising our canned meat products and actually have no relationship whatever with purchases from us either in quantity or in price. The amount of money in question we understand is used by the firms involved to offset their expenses in newspaper advertising, island and window displays, and general promotional work."

Then, there were those cases in which the payment was related, in one way or another, to the amount of sales. And, for this

category of payment, promotional payments were sometimes tied closely to the performance of services, sometimes they were tied loosely, and sometimes not at all.

> "This is a continuing per case allowance offered to all retailers purchasing our products, either direct or indirect, who advertise at least once weekly in a daily or weekly newspaper and who agree to advertise and provide displays as designated by us.
>
> A Marketing Agreement Form is prepared quarterly for all customers who may be eligible to participate, and who agree to perform. The amount to be earned is based on a preceding three months' purchases. It must be understood therefore that a portion of the Marketing Allowance granted for 1954 was governed by sales values for part of the year 1953 and this is reflected in the attached report. Also in the event that a retailer does not fulfil all the requirements under agreement for all products, the Company allows payment on a partial basis."
>
> \- - -
>
> "The purpose of the [per case] Allowance is to defray the cost to our buyers for their ["Y"] Brand advertising and sales promotion and for constructively building the distribution of ["Y"] Brand Products.
>
> . . .
>
> Some of the means and methods distributors may use in the advertising and sales promotion of ["Y"] Products, within the scope of and in compliance with this contract, are as follows: 1. Store Displays, 2. Window Trims, 3. Display Materials, 4. Advertising Production, 5. Handbills and Circulars, 6. Newspaper Advertising, 7. Radio Advertising, 8. Television Advertising, 9. Special Events, 10. Sales Contests, 11. In-Store Advertising, 12. Outdoor Signs, 13. Order Books and Catalogs[sic], 14. Demonstrations, 15. Trade Meetings.
>
> . . .
>
> Buyer agrees that he will use the funds provided herein for the purposes set forth. . . ."
>
> \- - -

"As an important supplement to our advertising program in magazines, newspapers and on the radio, we establish for each quarter of the year a sum of money we can afford to spend for special retail advertising and promotional support. A pro rata portion of this money is set up as an available budget for a list of accounts whose advertising and promotional facilities are such as to give us the greatest supplementary advertising value in return for the money we can afford to spend. The pro rated amounts budgeted are determined by the volume of each accon account in relation to the total for the groups selected and is the maximum amount allowable for such services. At the end of each quarter these accounts bill us for specific performance as agreed upon in advance between themselves and our local branch managers."

". . . we pay chain grocery organizations a 7% rebate. This is in effect an advertising and promotional allowance which is paid quarterly on receipt of advertising or special promotion. We ask for tear sheets or a schedule of newspaper advertising and dates on which special store displays were set up for our products. For this special allowance we request advertising in the chain stores regular weekly ads; we ask for basket displays and end displays periodically in the stores.

. . . Our general policy is to pay 50% of the cost of advertising, but in special instances we pay the full cost of the advertisements."

Finally, there were those allowances related to sales in return for which no performance was presumably required. The following are typical examples:

"We allow a 5% rebate on purchases made by chain stores and wholesale grocers during the previous 6 months. This is called an advertising allowance."

\- - -

"We allow a 5% rebate which is called an 'advertising allowance'".

\- - -

> "The chain stores do buy according to a chain store list, and in addition they get a so-called 'advertising discount' which they receive every three months."

In two of the "advertising allowance" arrangements in which the allowance was calculated as a percentage of sales, a restrictive clause was included limiting in a significant way the use to which the allowance could be put.

> "This Allowance is not to be considered in any way as a Trade Discount. Our buyers are not to use the Allowance in determining their landed cost or reflect it in their retail sales price."

- - -

> "Basic to any such co-operative advertising agreement is the mutual understanding that any percentage allowance of the annual net purchases of ["Y's" products] by [wholesaler "X"] and its subsidiaries must be for advertising and sales promotions and not for cutting prices which would give you and your affiliates a definite competitive advantage over other wholesalers whose annual net purchases would not enable them to qualify for such an allowance."

A third supplier had a somewhat less explicit restriction in his "Co-operative Advertising Plan";

> "Customers receiving the Goodwill allowance under this plan agree to use the same for the sole purpose outlined above and agree the said allowance will not be shared by method of trading or otherwise with any outside party."

A number of distributors (of which two were referred to above, p.174 ) indicated a strong preference to receive special discounts and allowances in the form of payment for promotional services, specific or general, rather than in the form of a larger discount which would come off the face of the invoice. A recent study of "trade deals" in the United States suggests a possible reason for this preference:

"Incidentally, in connection with certain types of allowances - 'display' allowances, for instance - the retailer doesn't want the payment to come off the face of the invoice. He usually prefers seperate payment - otherwise, he contends, the allowance is apt to wind up as a reduced shelf price."[1]

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1. E. B. Weiss, <u>130 Tested Trade Deal Strategies and Their Tactical Development</u>, (Doyle, Dane, Bernbach, Inc., 1957), p. 26.

Certain of these briefly quoted views taken together with the general information on the magnitude of special discounts and allowances reported in an earlier section raise some question as to whether the emphasis in grocery distribution is shifting from the price basis, traditional in this field, to advertising and various types of promotional activity. Furthermore, the extensive and apparently increasing use of payments for promotional services, particularly to large distributors - whether these take the form of payments for specific promotional services, payments for general, unspecified promotional services with a restrictive clause prohibiting the use of such payments for price reductions, or merely promotional payments with no strings attached but which are not shown on the face of the invoice and swell the general fund for promotional activity - raises important questions as to the role of the "big buyer" in bringing pressure to bear on producers' costs and passing on the savings to the consumer. In part, the apparent increasing importance of advertising and promotional payments to the "big buyer" may represent the most efficient use of funds by the supplier for sales promotion; in part, it may represent the transfer, under the pressure of superior bargaining power, of advertising expenditures from the supplier to the "big buyer"; in part, it may represent a competitive device which when used by one supplier obliges others to follow suit with cumulative effect; and, in part, it may, as implied above, represent an evasion of price competition.

The following letter from a supplier emphasizes the importance of the buying power of the chain stores in obtaining promotional payments and also the use of allowances as a competitive device among suppliers:

> "Many manufacturers allow a quantity discount which may take the form of an initial low price or a rebate on a certain volume being attained. In Chains, because of their purchasing price [power? ], additional price concessions are obtained regardless of the quantity from firms who are anxious to have their product available in these Chain stores.
>
> The most pernicious form of rebate that is currently required by Chain stores is that of 'promotion allowance'. Before any of the large Chains will give special display space to a product, they insist on a payment that can run as high as $75 per store per week. Some Chains will refuse to stock an item unless a prior commitment of 'promotional advertising' is made by the supplier.

> Conditions have reached the stage whereby 'promotion allowances' are the competitive weapons used by competing suppliers - and the method employed is equivalent to nothing more or less than hidden discounts.
>
> It is obvious, therefore, that from the supplier's point of view he is being gradually forced to 'rent' space for his product on the shelves of the large Chain stores. No independent would dare ask for such an arrangement and therefore being without this source of income is once again at a competitive disadvantage with the Chain store."

Although no supplier stated that he obtained a better return for his advertising dollar when it was paid out as a promotional allowance to distributors than when he expended it directly for advertising through customary media, there were such comments as:

> ". . . when we do buy promotional support we have carefully studied the outlet's proposition and determine it to be of very real value, likely to result in additional business in our lines."

- - -

> "Some retailers, due to their effort in selling our products, get an advertising allowance according to the amount of advertising they perform for us. . . . There is no fixed allowance. It is based on the value received."

However, another supplier made the following comments:

> "The pressure . . . for co-operative advertising dollars from the trade is being experienced generally and there is no end to the variety of promotions the trade have to offer. . . .
>
> It is difficult to assess what extra sales are made when our products are featured, also whether our media advertising would be sufficiently strong in itself to hold our sales position. . . .
>
> It is also difficult to determine how much of our co-operative advertising dollars are used for advertising and how much goes to buying support of either shelf space or listing by wholesalers."

## Individual Cases of Very High Rates of Special Discounts and Allowances to Sales

The average rates of special discounts and allowances to sales for various buyers have been reported in an earlier section. The maximum level of rates was generally below three per cent. This was true, as well, when sellers were grouped by size, with only one exception: sellers having a sales volume of two to three million dollars paid average special discounts and allowances amounting to 3.42 per cent of sales. There were, however, a number of cases in which individual buyers received very much higher rates of payment. The following are the cases in which the rate was 10 per cent or more.

A supplier paid most distributors allowances and rebates amounting to something in the neighbourhood of five per cent of sales. One wholesaler, however, received allowances of $719.84 and made purchases of $2,341.85 - a rate of almost 30 per cent.

A supplier whose "special advertising allowance" arrangements displayed no central percentage relationship between sales and allowances, paid a wholesaler allowances of $313.00 and made to it sales of $785.00, that is, allowances were approximately 40 per cent of sales.

Another firm paid a chain store an "advertising allowance" of $1,160.00, whilst its sales to the chain were $5,200.00; a rate of about 22 per cent. Payments to other buyers were at a much lower rate.

A supplier made sales of $1,532.00 to a chain store and paid it $200.00 for "advertising and store display", that is about 13 per cent of sales. Payments to other buyers were highly erratic on a percentage basis. Another chain store made purchases of $13,889.00 and received allowances of $1,672.89, about 12 per cent, whilst a third chain made purchases of $12,194.00 and received nothing in allowances.

A supplier paid a chain store, making purchases of $2,650.00, $500.00 in promotional allowances, that is about 19 per cent of sales. Other chain stores making purchases of $5,645.00 and $6,444.00 received nothing in allowances.

A chain store received $500.00 in promotional allowances from a manufacturer and made purchases from the same firm of $1,930.00; that is allowances were about 26 per cent of sales. Another chain with purchases of $15,208.00 received $484.75 in allowances, about 3.2 per cent of sales.

A supplier reported making sales of $2,668.00 to a chain store and paying the same buyer $280.00 in promotional allowances, that is about 10.5 per cent of sales. Another chain made purchases of $7,117.00 and received allowances of $186.20 (2.6 per cent), whilst another with purchases of $2,437.00 received nothing in allowances.

A chain store received $220.00 in special allowances from a supplier from whom it made purchases amounting to $884.00 - that is, allowances were about 25 per cent of sales. Another chain made purchases of $4,250.00 and received allowances of $135.24 - about 3.2 per cent.

A supplier paid a chain store $675.00 for "Advertising, etc.", and made sales to the chain amounting to $3,458.00; thus allowances were about 19.5 per cent of sales. To another chain, the same supplier made sales of $37,564.00 and paid allowances of $50.00; and to another, sales of $99,176.00 and no allowances.

A wholesaler made purchases from a supplier of $1,109.00 and received allowances of $110.89 - 10 per cent. Other wholesalers made purchases of $2,081.00 and $1,055.00 and received no special discounts or allowances.

A supplier made sales to a wholesaler of $1,588.95 and paid special allowances of $301.52, that is 19.5 per cent of sales. Other wholesalers and chain stores purchased much larger amounts at special allowance rates varying from zero to six per cent.

A wholesaler made purchases of $26,280.00 from a supplier and received allowances of $3,525.04, about 13.5 per cent of sales. Other wholesalers made purchases of $66,993.00, $39,000.00, and $29,180.00, and none received any special discounts or allowances.

A chain store made purchases of $11,986.00 and received from the supplier the amount of $3,377.97 in special discounts and allowances - about 28 per cent of sales. Another chain store with purchases of $37,736.00 received $8,109.56 in allowances - about 21 per cent of sales. Still another chain made purchases of $102,576.00 and received discounts of $4,309.88, about 4.2 per cent.

A supplier made sales of $6,496.00 to a chain store and paid the firm $1,400.00 in special discounts and allowances, about 21 per cent of sales. Another chain made purchases of $8,093.00 and received allowances of $812.00 - about 10 per cent. Whilst another made purchases of $34,798.00 and received $800.00 in special discounts and allowances - about 2.3 per cent of sales.

In addition to these cases carrying special discounts and allowances equal to 10 per cent or more of sales, there was a much larger number which reported such payments amounting to five to 10 per cent of sales.

These examples will serve to call attention to the most extreme values in the data on which the averages reported in earlier sections of this study were based, although the firms granting these very high rates of special discounts to certain buyers did not show a general tendency to pay higher average rates of special discounts on their total sales than other firms in the same size class. In only a very small proportion of these extreme cases was it indicated that advertising or promotional performance was required in return for the allowances granted. It is also noteworthy that the suppliers granting these allowances tended to fall in the small-firm size category; only two had annual sales in excess of $1,000,000.00, and they were in the medium-size class. Such firms are not likely to enjoy any substantial degree of bargaining power.

## Desirability of Review by Manufacturers of the Special Discounts and Allowances Disclosed in the Survey

In the course of submitting this information on special discounts and allowances, a few suppliers raised directly the question whether their arrangements were discriminatory. One supplier pointed out the difficulty that was involved in spending "exactly the same proportionate amount of money with all distributors". This letter continues:

> "In each of these geographic areas we treat all customers alike on the theory that we must not show favoritism to any account which is competing with another account in a given area. From our division of marketing areas above, it becomes obvious that what we do for an Ontario account has no competitive bearing whatsoever on what we do for an account in Vancouver.
>
> . . .
>
> In deciding how much money to spend with any one account we have used as a rough guide 3% of their annual purchases. This brings up a definite problem because we find that the cost of a promotion which a distributor must make available to everyone at an equivalent price is often above or below our average amount of money we plan to spend with these accounts.

In that event we watch them over a period longer than one year and do everything possible to equalize our expenditures for such promotions with such companies.

You can see that some companies are extremely active in offering excellent promotions to manufacturers. These companies undoubtedly get a larger share of promotional money from manufacturers. An example is the Ontario situation described below with reference to cooking schools.

. . .

An example of the inability of any manufacturer to spend exactly the same amount of money with any one account on special promotions is the situation with regard to two of our Ontario accounts. We buy 'cart card' promotions from one account on various products, usually two or three times a year. We asked another account a short time ago to let us buy from them their equivalent promotion. We were turned down on this for the reason that they felt the market was too 'hot' for our brand."

The question raised by the small number of suppliers, concerned about the possibility of discrimination in their arrangements, most frequently related to the payment of special discounts and allowances to buyers purchasing relatively large amounts of the supplier's product(s) on a basis that was not available at all, or available on proportionately less favourable terms, to buyers making smaller purchases. It was frequently explained that if the buyer taking the smaller amount were prepared to increase his purchases to the higher amounts taken by the larger buyers, the supplier would be prepared to accord such purchaser the same favourable treatment on special discounts and allowances granted the larger buyer. The "smaller" buyers were not always smaller in the size of their overall distributing operations but often only in respect to their purchases from the supplier in question.

A general analysis of the replies to the questionnaire on special discounts and allowances disclosed a considerable number of cases, many of which differed from the type just referred to, which appeared to raise questions of the kind of discrimination envisaged by section 412, even if the facts would not necessarily fit into the provisions of that section. It should be emphasized, in this respect, that the inquiry was not instigated by specific complaints nor directed to the investigation of specific suspected offences. The inquiry,

rather, was conducted with the co-operation of all parties concerned for the purpose of determining whether discrimination might be taking place, whether complained about or not, and whether or not answering to the technical requirements of section 412. A specific investigation, under section 412, must concern itself with a considerable number of exact issues, for example: at what stage do separate discriminations amount to a "practice of discrimination"; in what circumstances, having regard to their individual markets and functions, are dealers to be considered as "competitors"; in what circumstances may price concessions be described as being equally "available" to competitors; and in what circumstances is preferential treatment to be related to a "sale of goods" and in what circumstances to a collateral agreement. The information gathered in the course of this inquiry, while sufficiently precise to bring out the existence and general nature of discriminations, did not attempt to explore the above-mentioned issues in individual cases and it was not the intention of course, in commencing the inquiry, that it should do so.

Having regard to the foregoing considerations, it is only possible to reach a number of general and tentative conclusions. The first such conclusion is to the effect that there appear to be present in the grocery trade a considerable number of instances of the <u>kind</u> of discrimination to which section 412 relates. The second conclusion is to the effect that, if a case by case examination were undertaken, it is not unlikely that examples of discrimination would be disclosed that met the technical requirements of section 412. The third conclusion is to the effect that it would be well for merchandisers in this, and perhaps in other fields, to examine or re-examine their price structures in order to avoid the possibility of discriminatory practices of a <u>kind</u> not warranted on economic grounds and which work unfair hardship on certain types of dealers. This last consideration is elaborated in the concluding chapter.

Cases encountered in the course of the inquiry which raise a question of discrimination of the <u>kind</u> envisaged by section 412 fall into two clearly defined groups: first, those cases in which special discounts and allowances for promotion and advertising are related on a percentage basis to sales, and of this type there were very few; and, second, those cases in which it was claimed that, to quote one reply, "The amounts paid are not related to the quantity or price of goods purchased, but rather to the value of the advertising received." It should be added that few of the returns which related special discounts and allowances to advertising and promotional services rather than to sales, indicated that there was any close connection between the amounts of the payments and the value of the services received.

In order to appraise the presence and extent of discrimination of the kind envisaged by section 412, the returns to the Questionnaire on Special Discounts and Allowances were analysed on the following, conservative, basis:

(1) Comparisons of sales and allowances were limited to buyers that might be expected to carry on operations in the same geographical area, hence be "competitors".

(2) Only if a buyer made purchases from the supplier in question which were equal to, or less than, those made by another buyer, and received larger special discounts and allowances than the buyer taking the equal or larger volume of sales, was the arrangement placed in the "questionable" category. Or, since in practice the cases in which sales were equal for different buyers were non-existent, only when, during the year covered in the questionnaire, buyers making smaller purchases received a higher rate of payment for special discounts and allowances than their competitors making larger purchases from the same supplier, was the arrangement considered to be "questionable". If buyers of large and small amounts were treated alike, the return was passed over. Similarly, when buyers of larger quantities received more favourable treatment than their competitors who purchased smaller amounts, the return was also passed over, even though a number of such arrangements contained elements that appeared to be discriminatory in the economic sense.

(3) Although it was not possible to determine, on the basis of the information available in the returns, whether or not the supplier granted the discriminatory allowances as part of a practice of discriminating, no case was included in the "questionable" category unless purchases by a favoured buyer reached at least $1,000.00, thus excluding small, incidental sales.

It should be noted, parenthetically, that those firms receiving apparently preferential treatment, whether they were purchasers of large or small amounts from a given supplier, were not necessarily the larger buyers in terms of their over-all purchases from all suppliers. Indeed, one or more chain stores that enjoyed a high degree of success in obtaining favourable rates of allowances relative to sales were among the smaller firms of the six leading chain stores in Canada, and one firm that rather consistently received a relatively low rate of allowance on sales was one of the medium-size chains.

To return to the basis used in classifying the returns into "questionable" and "other" categories, the reasons for restricting the "questionable" category to those cases in which buyers of smaller amounts received more favourable treatment with respect to special discounts and allowances than buyers of larger amounts, whilst excluding from that category buyers of larger amounts that received more favourable treatment than buyers of smaller amounts, are:

(1) Although the general purpose of the legislation, as stated in the Price Spreads Report, was to limit any undue buying power of the "big buyer", there is nothing in the legislation requiring that the buyer of smaller quantities should be accorded equally favourable treatment - either by a cost justification requirement, a "proportionally equal" requirement, or some other - to that accorded the buyer of larger quantities.

(2) The legislation does, on the other hand, prohibit the granting, in connection with a sale to buyer "A", of "any discount, rebate, allowance, price concession or other advantage" that is not available at the time of such sale to competitors of "A" in connection with "a sale of goods of like quality and quantity".

A fortiori, the granting of special discounts and allowances on a larger scale to buyer "A" when buyer "B" is a larger purchaser from the supplier would suggest discrimination of the kind envisaged by section 412 and appear to raise the possibility of infringement of that section.

It will of course be remembered that, as already indicated, the inquiry did not involve the matching, for purposes of comparison, of the treatment accorded competing customers by a particular supplier in respect of like quantities of an identical article at an identical point of time.

The prominence which a number of suppliers have accorded, in their replies to the questionnaire on special discounts and allowances, to the qualification that such discounts and allowances "were not related to either prices or sales" apparently stems from the fact that 412(1)(a) prohibits discriminatory treatment in connection with sales of goods of like quality and quantity. If the differential treatment were related to the buying of promotional or advertising support rather than to sales, it was apparently believed that the section would not apply. Some doubts may be expressed about the validity of this view. In general, it seems probable that the reason for granting differential treatment with respect to special discounts and allowances

is not unrelated to the fact that the recipient of such discounts and allowances is a customer purchasing goods from the supplier granting the discounts and allowances, and that, therefore, there is at least an indirect if not a direct relationship to sales. Certainly, no case was encountered in which payments for advertising and promotional work were made by suppliers to distributors when such distributors made no purchases from the supplier granting the payments, and none could realistically be expected. It is worth recalling that the section applies to the making of any sale that discriminates "directly or indirectly" against competitors of the purchaser. The granting of a discriminatory discount in the form of an advertising or promotional allowance for which only token performance, if any, was required could scarcely hope to escape the prohibition of the section. Even where some reasonable performance was required, it would appear that competitors of the purchaser who was granted payment for such performance might, in this era when advertising so strongly influences the fortunes of distributors, make out a case that they were being discriminated against, within the meaning of the section, provided they were able and willing to perform the type (or a similar type) of advertising and promotional services involved.

On this general and necessarily incomplete basis of analysis, a surprisingly large proportion of the returns fell into the "questionable" category. In all, there were some 300-odd returns that provided information in sufficient detail to justify the attempt at classification and, of these, 109 appeared to raise some question as to whether discrimination of the kind envisaged by section 412 or even discrimination directly infringing section 412 was involved.

Only a few of the "questionable" cases were found among those returns in which special discounts and allowances were related to sales on a percentage basis. The following data apply to one such case:

| Chain Store | Net Sales | "Commercial Discount" | | "Sales Promotion" | |
|---|---|---|---|---|---|
| | $ | % | $ | % | $ |
| "A" | 88,455 | 10(11.1) | 9,828.36 | 2-1/2 | 2,211.38 |
| "B" | 333,271 | 10(11.1) | 37,030.11 | 2-1/2 | 8,331.77 |
| "C" | 11,889 | 10(11.1) | 1,320.98 | 2-1/2 | 297.22 |
| "D" | 132,240 | 12(11.3) | 15,027.22 | 2-1/2 | 3,305.99 |
| "E" | 5,715 | 7(10.8) | 617.87 | 5 | 285.77 |

Whether the rates considered for "Commercial Discount" are the percentage rates reported by the supplier or those computed on the basis of the dollar amounts of "commercial discount" reported (shown in parentheses), it would appear that chain store "D" received somewhat better buying terms than its competitor, chain store "B", whose purchases were approximately two and one-half times as great

as those of "D". In this instance, "D"'s over-all operations were on a substantially smaller scale than "B"'s. With respect to the rate for "Sales Promotion" and the total rate paid for "Sales Promotion" and "Commercial Discount" combined, chain store "E" received substantially more favourable treatment than its competitors, all of whom made larger purchases from the supplier in question. Chain store "E" is one of the smaller chains in the group.

The "questionable" cases in which special discounts and allowances were not related directly to sales were very much of the same type as the following example:

| Chain Store | Net Sales | Special Discounts and Allowances | % |
|---|---|---|---|
| | $ | $ | |
| "A" | 120,135 | 4,725 | 3.9 |
| "B" | 210,302 | 1,054 | 0.48 |
| "C" | 208,388 | 2,056 | 0.9 |
| "D" | 63,251 | 2,162 | 3.4 |
| "E" | 22,845 | 1,000 | 4.4 |

The supplier in this case reported that the special discounts and allowances were paid for "specific services of an advertising or promotional nature". The differential treatment accorded "E" and "B" is particularly noteworthy. "E" is one of the smaller firms in its over-all operations and "B" is of medium size, whilst "C", also a disfavoured buyer, is one of the larger chains.

The remaining "questionable" cases tend to be of this general type, although the favourable treatment accorded the buyer with the smaller over-all operations in the above example is not necessarily the characteristic situation. For example, cases such as the following - with the exception of the very high percentage differentials - are not uncommon. The special discounts in this case were reported by the supplier to be "Special Advertising Allowances".

| Chain Store | Net Sales $ | Special Discounts and Allowances $ | % |
|---|---|---|---|
| "A" | 6,496 | 1,400.00 | 21.5 |
| "B" | 8,093 | 812.00 | 10.0 |
| "C" | 14,591 | 500.00 | 3.4 |
| "D" | 34,798 | 800.00 | 2.3 |
| "E" | 12,836 | 375.00 | 2.9 |

In terms of the size of their over-all operations, chain stores "D" and "E" are the smaller ones of the group and chain stores "A" and "C" the largest.

It should once again be pointed out that the designation of "questionable" in this classification of cases was made on the basis of the interpretation of section 412 set out earlier in this section and of data not specifically intended for such an appraisal. More complete information might reduce or it might increase the numbers in the "questionable" category. In any event, the factors involved in the present classification of cases have no necessary relationship to the considerations discussed in the chapter dealing with the economic analysis of price discrimination.

## CHAPTER VIII

## CONCLUDING COMMENTS

No attempt will be made to summarize point by point, the information brought together in this inquiry but it may be worthwhile to recall some of its major features and to indicate the nature of some of the economic issues involved.

The major source of differential treatment of grocery distributors appears to be found in special discounts and allowances. Although the information received on discount structures suggested that significantly large price differentials were possible on the basis of such structures - particularly where cumulative discount systems were employed - the more specific survey of prices to chains and wholesalers in the Toronto area failed to turn up any significant invoice price differentials as between such categories of buyer or among buyers within each category.[1] On the basis of the general survey of suppliers, the differentials in the rate of special discounts and allowances as among chain stores and wholesalers and as between chains and wholesalers would properly, in the context of margins in this field, be regarded as "substantial". This is notably the case in wholesale trade.[2] The less favourably treated buyers received average rates of payment as low as one-third those of their favoured rivals.

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1. Some differentials provided for in discount structures do not ordinarily appear on the face of the invoice and so would come under the heading of special discounts and allowances. Certain types of cumulative discounts would fall into this category.

2. The following quotation from a report in Canadian Grocer, March 1, 1956, emphasizes the importance of special discounts and allowances:

> "R.H. Judge, Lakehead food broker, declared many wholesalers are fighting for survival. Two he knew of depended entirely for their net profit on cash discount and special allowances. Mr. Judge pointed out that more wholesalers are adopting cost plus plans selling to their retailers at their gross cost plus a small percentage markup, and depending upon the cash discount or allowance to make the sale profitable."

This statement implies, it should be noted, that special allowances made by suppliers are not matched by equal outlays on promotion by the wholesalers receiving them.

Assuming, then, that substantial differentials in treatment of different categories of grocery buyers (and of buyers within each category) exist and that the differentials are found in very large measure in the payment of special discounts and allowances, what can be said about the significance of such differential treatment?

The fact that certain buyers were disadvantaged by the differential treatment, would not necessarily mean that it would be criticized from the economic point of view.[1] It was pointed out in the section on "the big buyer" that in certain circumstances discriminatory buying terms could be the means of improving economic performance.

The evidence obtained in this inquiry does not make possible a definitive exploration of the issues just mentioned; in fact, only a detailed inquiry into the impact of buyers on specific sectors of the market, such as the distribution and pricing of soaps and detergents, of meats and allied products, of canned fruits and vegetables, and the like, would provide the necessary information for an exhaustive analysis. Nor is such an exhaustive analysis necessarily required to reach general conclusions. The following considerations are of obvious importance.

First, the major circumstance in which it can be argued that the pressure of big buyers for favoured treatment contributes to improved economic performance is where, among other things, it is exercised against oligopolists pursuing closely co-ordinated pricing policies, thereby fostering price competition, with the advantages being passed on to consumers. The material on chains' purchases and rates of special discounts by size of supplier did not support the view that the chains enjoyed particular success in obtaining special discounts and allowances from the largest sellers. Nor was there evidence that the differential advantages accruing to the chains generally took the form of lower buying prices; on the contrary, there was some evidence that certain chains (and wholesalers) preferred to receive favoured treatment in the form of advertising allowances which were divorced from the invoice price of the product.

Second, if the pressure for advertising and promotional allowances by buyers were to result in (a) an over-all reduction in the amount devoted to such purposes - thus reducing marketing costs, or (b) the more efficient use of the funds allocated to such purposes by suppliers, such pressure might be considered advantageous. Such limited evidence as was obtained relative to (a) suggested that the tendency of pressure from large buyers was rather to increase the total amounts devoted to advertising and promotional activity, and this

1. It does not follow that economic factors are the only ones to be considered.

evidence receives support from reports in trade journals.[1] As to (b), some suppliers claimed that they received no return in terms of promotional services for their "advertising allowances" - they were merely renting shelf space; others stated that it was not possible to assess what contribution, if any, was made to the sale of their product by their purchase of distributors' promotional support; whilst others reported that they made allowances to distributors for advertising and promotional services only when the results justified the payments.[2]

These considerations are referred to, not because they are of final and determining importance in evaluating the impact of differential treatment of grocery distributors, but as being suggestive of the types of issues that merit careful consideration. Other questions relating to the trend of distribution costs in this field, the possibility of encouraging price competition through price discrimination that accords closely with costs, as well as the general issues reviewed in Chapter II are close to the heart of the matter. Stated briefly, the basic problem is to assure that success in distribution results from increasing efficiency and not from the exploitation of strategic market positions. Then again, considerations of a non-economic, social character will figure significantly in any assessment of pricing and distribution policies.

Finally, and as already suggested, it would appear very desirable that suppliers, from time to time, review their price structures in order to ensure, not only that section 412 of the Criminal

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1. The level of advertising expenditures in Canada and recent trends in such expenditures are reported by DBS in Advertising Expenditures in Canada, 1954 (Reference Paper No. 67, 1956). It is of interest to note that the ratios of advertising expenditures to sales for the four retail groups of interest to this study are:

| | |
|---|---|
| Independent grocery stores | - 0.21% |
| " combination stores | - 0.30% |
| Chain grocery stores | - 0.65% |
| " combination stores | - 0.71%. |

2. The element of performance, frequently claimed to account for much of the difference in special discounts between chains and wholesalers, would presumably be more important for the last category than for the other two, for which bargaining power would be the more basic factor accounting for the payment of special discounts.

Code is not being inadvertently infringed, but also to ensure that no unfair and unjustified disadvantages are being imposed unnecessarily and persistently on any type of distributor, and particularly the smaller type of distributor. The reference to "price structure" in this paragraph is intended to include, not only ordinary price structures, but also special discounts and allowances. In respect of the latter, it would seem reasonable to expect that suppliers would, in general practice, and insofar as they grant such special discounts and allowances, endeavour to see that they are available on reasonably proportionate terms to all customers. Where value is exacted for such special discounts and allowances in terms of advertising or promotional services, it seems reasonable to expect that suppliers would take into consideration the different kinds of advertising and promotional services which different types of distributors are capable of providing, and organize their special discounts and allowances programmes in such a way that the different types of distributors can all take advantage of them. Suppliers might also review the desirability of reducing their expenditures for special discounts and allowances and offering in their place lower prices to buyers which would be more apt to be passed on to the consumer.

# APPENDIX I

## THE PRICE SPREADS REPORT AND PRICE DISCRIMINATION

The following quotations taken from the Report of the Royal Commission on Price Spreads provide a brief summary of the factors and the analysis that underlay the original recommendation for legislation to deal with price discrimination and also the particular form which that legislation was given. It is important to recall that the Report was written against a background of severe and continuing depression.

The following quotation makes up part of the discussion in the Report of "several basic consequences" of the development of "imperfect competition".

> "Many unfair practices take the form of price discrimination. This inevitably develops when there is considerable unused capacity. If a producer can attract new business at reduced prices while keeping all his former business at the old price, he can gain by the transaction as long as the new business pays anything more than the actual increase in costs which results from it, that is, beyond what the costs would have been if the added business had not been found. Thus occurs the paradox of profit-making sales 'below cost,' below, that is to say, the total cost which a conservative accounting system would allocate to those goods. Such discrimination is, of course, only possible where the market can be divided into distinct parts.
>
> Where discrimination develops, serious problems arise, problems of justice to the individuals subject to discrimination and problems relating to the public interest. The serious nature of these problems was demonstrated during the period of cut-throat competition between American railroads in the two decades prior to the Interstate Commerce Commission Act of 1887. In the effort to secure traffic, secret rebates and special favours were so rampant that success in industry came to depend on ability to secure favours from the railroads. The railroads held in their hands the power to determine what firms should survive in any industry, what industry would expand, what region would prosper. Such power obviously could not be permitted to irresponsible private corporations as an incident of their own warfare. The

Interstate Commerce Commission, therefore, was established in the United States in 1887 to regulate railway rates and especially to eliminate unreasonable discrimination.

Our evidence demonstrates that, in manufacturing and distribution, price discrimination has become very common. The reason is that the proportion of overhead costs is high and different markets are more or less distinct. Under these conditions, a manufacturer may sell the same commodity at two or more different prices. His branded product will be offered to his regular distributors at a price which covers all costs. But a sizeable proportion of his output, perhaps unbranded, or disguised under a special brand, may be marketed through other channels at a price less than sufficient to cover a fair share of overhead costs, in the belief, often mistaken, that these outlets constitute a market sufficiently separate not to affect the customary price for the product. Similarly, a department or chain store may sell certain goods at prices which do not include overhead, in the expectation that they may recover the loss on other goods.

Where discrimination of this sort exists, the competitive struggle does not necessarily result in the selection of the more efficient. Thus, an injury to the public accompanies the obvious injury to those who are not so lucky as to be the recipient of such favours. Some discrimination is admittedly desirable when sales in quantity involve real economies or when a buyer smooths the 'load' by giving his orders to be made 'off the peak', but there is also unreasonable discrimination which should be controlled.

Fourth, under imperfect competition, the bargaining advantage of strong organized groups may lead to the exploitation of the weak and unorganized. Faced with losses as the revenue from sales decreases and the expenses of the competitive struggle increase, powerful corporations naturally seek to shift the burden of their losses on to others. This has brought into bold relief the inequality of economic strength when the giants of monopoly and imperfect competition meet in the market the pigmies of unorganized, small-scale, competitive enterprise. As long as simple competition predominated, one could expect that the price reached by buyers and sellers would be more or less fair, and, further, that it could not be altered without causing the cancellation of

many contracts. In other words, bargaining was fair and equitable. But when the one mass buyer, or the few mass buyers, meet the many weak competing sellers, then there are possibilities of exploitation. In an effort to avoid such exploitation, workers have organized trade unions and governments have enacted minimum wage laws. But there are groups of self-employed primary and small secondary producers who remain subject to such exploitation.

It is not enough to say, as many contend, that these problems are the result of depression and will vanish with the depression. It may be true that when recovery is achieved, competition will become less predatory, discrimination less general, and exploitation less obvious. But it is equally true that, while unfair competition and unequal bargaining are intensified by depression, they will not be absent in prosperity, especially in a prosperity characterized by the increasing substitution of imperfect for free competition."

(pp. 7 - 8)

The following quotation reports the conclusions of the Commission on the subject of "Large-scale Organization and Mass Buying".

"3. CONCLUSIONS

The mass buyer has been accused before us of deceitful, fraudulent, and sometimes criminal practices in his buying. As no definite proof of such underhand methods has been submitted, it is hardly fair to refer to them specifically, although it is admitted that satisfactory evidence as to their practice is almost impossible to secure. We are impressed, however, with the strain under which the individual buyer may find himself and the pressure that the modern large-scale merchandising system engenders. Undoubtedly, individual buyers have, in certain cases, violated all the rules of fair play, though there is no suggestion that such unethical conduct has any part in the declared policy of mass buyers. They must, however, accept some responsibility for the development of a system which at times provides the motive and opportunity for malpractice and under which the manufacturer, usually at a bargaining disadvantage, may be ruthlessly exploited through the failure of one individual to maintain his standards of business morality.

It may be maintained that the acceptance of a contract by a manufacturer on the mass buyer's terms is sufficient evidence that it is profitable. Such a view may be sound in respect to dealings between many competing small sellers and small buyers. It may even be true when the mass seller meets the mass buyer. It is doubtful whether it is necessarily true of a bargain between one of many competing small sellers and one of the few mass buyers, especially in a period of shrinking markets. True, it may have been in the interests of the particular seller to take the contract rather than let it go to someone else, particularly if the manufacturer is hard pressed for working capital. On the other hand, it might have been in the interest of the whole group of sellers to agree that no one of them would supply the goods on the terms demanded.

In summary, the complaints against the mass buyers can be classified under two heads:-

a. That they have depressed the prices of manufactured goods, and of agricultural produce (such as milk, vegetables, turkeys, etc.). That they are responsible, through depressing prices, for the sweat-shop conditions existing in certain industries.

b. That they are driving the independent retailers to the wall and that these independents should be protected for the following reasons:-

   (1) They constitute a valuable social group which communities cannot afford to have wiped out.

   (2) They can defend themselves from 'fair' but not from 'unfair' competition.

   (3) Their elimination will result in growth of monopoly in the retail field.

Having stated and discussed the complaints, it is only fair also to consider the following persuasive argument often advanced in defence of mass buying.

During a business depression, when world prices are falling and all incomes are being reduced directly or indirectly by the fall of export prices, it is argued that a readjustment of the whole price structure becomes necessary. Retail prices normally are less flexible than wholesale prices and slower in responding to changed

conditions. The adherents of this view hold, therefore, that it is desirable to have in the economy a group of mass buyers who can act as agents to force prices down; that lower prices tend to increase sales, production, and employment, and to increase the real income of consumers by bringing many commodities within the range of prices that they can afford to pay. Some employment at low wages, it is claimed, is better than none; production at low profits or even slight losses is better than idle plants.

It is conceded that some readjustment is necessary. But if the readjustment must take the form of lowering, through mass-buying pressure, the prices of manufactured goods and of primary products to that point which permits the payment of very low wages, or the earning of very low farm incomes, then some agency must be designed to bring correlative pressure elsewhere. Freight rates, rents, taxes, insurance, bond interest, monopoly prices, debts and all other inflexible rates, prices, and incomes must be drastically reduced. All prices, all incomes and all values must be deflated equally. In view of Canada's economic structure, we do not regard this policy as either practicable or desirable, especially at this late date in the depression, and we, therefore, cannot regard this defence of mass buying as convincing.

It still seems to us that, quite apart from 'unfair trade practices' discussed later, this theoretical defence of mass buying overlooks the fact that the mass buyer brings his pressure on a group of workers, primary producers, and small manufacturers who are peculiarly defenceless. Any necessary social readjustment should not be concentrated primarily on such vulnerable groups. The mass buyers, moreover, do not pass on to the consumer all the price concessions they can exact. Their attempt to cover increased fixed charges and to maintain or increase percentage mark-ups shows that any such social benefit which might follow their operations would be only a small and incidental result of their attempt to protect their own favoured position."

(pp. 223-24)

The following quotation details the Commission's discussion of the "more common types" of price concessions.

"7. MASS BUYING AND PRICE CONCESSIONS

One result of mass buying is price discrimination where manufacturers quote different prices to different classes of customers. This appears to have its origin in the distinction that was formerly made by manufacturers between wholesalers and retailers. It was generally felt that, as the wholesaler purchased in much larger quantities than the average retailer, and as he also performed many functions not customarily performed by the retailer, he was entitled to certain price concessions. So long as the traditional wholesaler-retailer system of distribution remained undisturbed, little criticism was occasioned by the policy of such discrimination between buyers, although perhaps there may have been cases when large and well-established independent retailers believed they were entitled to price advantages which they did not receive. But the development of large scale retail organizations in recent years and the disintegration of the jobbing trade in many lines have tended to make the matter of price discrimination more a question of volume of purchases than of trade status, of bargaining power rather than of possible savings in manufacturers' selling costs.

A report made by our investigators covering 48 manufacturers supplying chain stores showed that in practically every case the chain stores had a considerable purchasing advantage over independents through quantity and trade discounts, free goods, advertising allowances, etc. In spite of this most of the manufacturers stated that their prices were uniform to all buyers. Apparently they interpreted this to mean prices before allowances or discounts which makes their statement both misleading and meaningless. The manufacturers we were told were very reluctant to give information about special allowances and occasionally refused outright. This reluctance is understandable in view of the fact that allowances, for no very obvious reasons, varied even within the privileged circle of mass buyers.

As there are many ways in which price concessions may be given, a better picture will be gained by considering some of the more common types.

1. <u>Trade Discounts</u>

These are a survival of the trade status mentioned above and were formerly the concessions allowed to

jobbers as distinct from retailers. A few examples can still be found where manufacturers maintain this distinction and treat chain and department stores in the same manner as independent retailers. In the majority of cases, however, chain and department stores secure the same discounts as jobbers, while independent stores, if they are permitted to buy directly, must pay the full list price.

The trade discount, however, is sometimes used as a means of discrimination between different classes of buyers in order to give advantages to some forms of distribution and to discourage others. There is no doubt about the unfairness of this type of discrimination. As pointed out in chapter IV, we found in our investigation of the distribution of rubber footwear that, while discounts for department stores were based largely on the quantity of purchases, the co-operative buying groups of independent retailers were not eligible for the larger discounts no matter how large their volume of purchases. The representative of the Rubber Footwear Manufacturers' Association admitted that the classifications used in the scale of discounts were not based solely on volume of buying and that, even if co-operative buying groups undertook the entire wholesale function, they were not given terms equal to other buyers of a similar volume, since the manufacturers wished to discourage distribution of this kind. Discrimination of this kind is clearly disadvantageous to the independent retailer organized in a co-operative chain and we unreservedly condemn it.

2. Cash Discounts

These, as their name implies, are concessions offered for cash or prompt payments. Little need be said of them because they are customarily offered to all buyers alike. However, if an independent retailer is not permitted to buy direct he is, of course, unable to take advantage of the manufacturer's cash discount. On the other hand, he could probably secure equal, or more favourable, terms for cash payment from his jobber.

3. Quantity Discounts

Under this general heading are grouped the various kinds of price concessions which are allowed for volume purchases. The nature and description of these concessions vary greatly between different manufacturers and in

different industries. The most equitable forms are those which are open to all buyers upon substantially the same terms. There seems little doubt that for many manufacturers large single sales offer real savings in selling or handling costs and are, therefore, extremely advantageous if they can be secured without too great sacrifice. The question naturally arises: are the economies involved in such selling the only basis on which differential discounts are given or is the scale of discounts a reflection of the manufacturer's desire to retain the custom of large buyers whose patronage he believes will not be held unless preferential treatment is accorded them? As has already been stated with reference to trade discounts, discrimination in price can only be justified if it represents lower costs in distribution, but if such discrimination is due only to the superior bargaining power of large buyers, it may be condemned as not socially advantageous and, more narrowly, as a form of unfair competition. But just what constitutes unfair price discrimination cannot be determined by any set scale of measurements. For some commodities and to some manufacturers a differential of 5 per cent would represent the maximum economies involved in large orders; in other fields a difference of 15 per cent between large and small orders might be justified. Much less defensible, on economic grounds, are discounts that vary with different purchases of the same quantity, or that are based on purchases spread over a period such as a year or on an increase in volume of purchases in a period, say, from 4,000 cases to 5,000 cases. In the same class for which little economic justification can be given are discounts based on the volume of purchases from a group of factories. For example, it was stated with respect to the quantity discounts allowed for purchases of tennis and rubber footwear from members of the Rubber Footwear Manufacturers' Association that the buying might be from one manufacturer or from all of them. It is difficult to see just what the savings would be if an order for, say, $80,000 were spread over eight companies. In view of the confusion which results when discounts and rebates are given for other reasons than those of economy in selling, there is a need for a careful survey of the practices now being followed and where obvious injustices are found for their regulation and, if necessary, prohibition by the Federal Trade and Industry Commission, which we later recommend.

## 4. Free Deals and Premiums

A free deal or premium deal may be defined as an offer or a giving of something for nothing, contingent upon the purchase of goods or services at a price. When the 'gift' is represented by an additional quantity of the goods purchased, such as giving a 'baker's dozen,' it is a free deal; when, however, dissimilar articles or tokens for fractional values of a range of premiums are 'given away,' it is a premium deal. The variety of forms in which deals may be given or the motives which lead manufacturers to offer them need not detain us. It seems obvious that in the long run the purchasers as a whole pay the cost of such deals. The principal effect seems to be, therefore, to introduce confusion, to render uncertain the true cost of the merchandise and, where the same terms are not available to all buyers, to permit secret discrimination. The standard argument for free deals and premiums is that they stimulate buying, but from the point of view of the purchaser it is hard to find any justificatory benefits.

## 5. Advertising Allowances

The origin of advertising allowances seems to have been in the desire of manufacturers to secure promotion of their products at the point of sale and their willingness to make contributions toward the expenses that dealers might incur in advertising their products. In recent years, the term 'advertising allowances' has been used to cover a wide variety of possible services. In fact it has often been a disguise for discounts or rebates in price. When the big retailer has special facilities for advertising a manufacturer's goods by including special reference in his newspaper advertising, by window display, or by demonstration on the floor, the retailer has an obvious right to sell these services to the manufacturer. But much of the evidence on advertising allowances that has been collected by our investigators, shows that the payments made or discounts allowed are related vaguely, if at all, to the performance of any definite services on the part of the retailer. In fact, advertising allowances were found to be based directly on volume of purchases. It is also clear that chain stores have received the largest share of such advertising allowance.

An American student of the problem has suggested that, in view of current confusion created by the use of advertising allowances, each trade should consider their regulation under the following conditions:-

a. That the term advertising allowance is, in the opinion of the trade, used inaccurately and unethically when it is applied to any part of a price offer or used otherwise than to denote a payment for the purchase of specific promotion services.

b. That advertising allowances are, in the opinion of the trade, unethical except when given as payments for specific promotion performances which are possible, practicable, and capable of being audited.

c. That advertising allowances shall be arranged for in agreements entirely separate and distinct from sales agreements.

d. That advertising allowance agreements shall definitely specify exactly how much shall be paid (in money or credit, goods or services) by the giver of the allowance, exactly what services shall be rendered by the recipient of the allowance, and the method of auditing performance which the allowance giver shall employ. [If the agreements referred to were envisaged as involving manufacturers in agreement as to the amounts and conditions of special allowances, then, of course, this might raise a question under the anti-trust or anti-combine laws.]

The trade should consider the advisability of condemning all advertising allowances which are secret on the ground that the terms of secret arrangements cannot be known and on the ground that the suspicion and mistrust engendered in the trade and the loss of time involved in transacting business in such a trade atmosphere offset such advantages as may be found in secret arrangements.(1)

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(1) L. S. Lyon - 'The Economics of Free Deals' (The Brookings Institution, Washington, D.C. 1933).

6. Demonstrators

Closely allied to the advertising allowance as it is used to-day is the provision by manufacturers of demonstrating sales clerks in the stores of retailers. This practice originated when expert salesmanship was required to introduce a new product to the public and manufacturers employed skilled retail demonstrators who went from one store to another, putting on special displays. To-day, however, we find manufacturers paying the wages, directly and indirectly, of a portion of the regularly employed sales force of department stores. In some departments virtually all the selling staff is on the payroll of one supplier or another.

Demonstrating allowances are often no more than additional price concessions, imposed on the manufacturer against his will and returning to him no benefit through the more zealous promotion of the sale of his product. It has become therefore an instrument of discrimination in the hands of the mass buyer and one method whereby the price policy of the manufacturer may be negatived.

7. Conclusions

Having considered the more common forms of price discrimination by which mass buyers are able to obtain preferential treatment, it remains only to draw the obvious conclusion. There is little serious objection to discounts, free deals, and allowances when these are available to all on the same terms, and are related to any measurable service rendered, or economy effected. At the worst they simply complicate the problem of accounting and costing. But when such concessions are given not in return for any service, not openly, and not to all on the same terms, they involve gross discrimination and become a powerful weapon by which mass buyers compete unfairly with their small rivals and use their massed purchasing power to take undue advantage of their weak suppliers."

(pp. 224-28)

Finally, the Commission's definition of "unfair trade practices" indicates the general setting in which price discrimination was placed and also those aspects of discrimination that were considered to be especially detrimental.

"(1) The Definition of Unfair Trade Practices

Unfair competitive practices take many forms, some of which are now prohibited by law. In respect to those the difficulty up to the present has been that there has been no administrative agency for the enforcement of such laws and the prohibition has therefore not been effective. A business man is never anxious to proceed against his competitor for the violation of rules of business conduct, even though that violation may have been definitely illegal. We therefore recommend that the Trade and Industry Commission should, in the manner and to the extent previously recommended in connection with consumer protection, supervise the enforcement of existing laws which prohibit certain business practices.

There are, however, other competitive practices which, while not illegal, may be equally unfair. These take many forms, but the majority of them may be brought under the definition of unfair price discrimination; 'unfair,' because it operates inequitably as between competitors, because the burden of it is often pushed back to the wage-earner or primary producer without corresponding benefits to the consumer, and because it deprives society of the benefits of fair and equal competition. Unfair price discrimination, or any other similarly unfair business practice, permits the survival of the powerful rather than of the efficient. The Federal Trade and Industry Commission should be given the duty and power of prohibiting such unfair trade practices.

We feel, further, that it would be unwise to attempt to write at present into statute law a rigid definition of what constitutes an unfair practice, with a list of such practices. Such a list, if appropriate at the present time, would probably soon be rendered obsolete by changing conditions. At the same time we recommend that the Act creating the Trade Commission and giving it power to prohibit unfair competition should establish certain principles for the determination of 'unfairness.' We recognize that there is a very real danger of confusing the economic, legal and ethical implications of 'unfairness' and we feel that this danger might be removed to some extent if certain general criteria were laid down in the Act. We suggest that practices should be prohibited as unfair which are characterized by bad faith, fraud, misrepresentation, or oppression; which are resorted to for the purpose of destroying competition or eliminating a competitor; which facilitate the

development of monopoly; or which destroy fair competitive opportunity and prevent the survival of those who can organize and carry on the production of goods most efficiently. It is in this sense that the word 'unfair' should be used in the Act.

Without attempting to restrict the application of this test of 'unfairness' by the Commission we feel that certain practices which we have examined should very definitely be considered 'unfair' under the Act. They are so widespread and generally condemned that their complete prohibition by the Commission is justified. We refer specifically to-

(1) discriminatory discounts, rebates and allowances,
(2) territorial price discrimination and predatory price-cutting."

(pp. 269-70)

These "certain practices" are the practices that were subsequently forbidden by Parliament in section 498A (now 412) of the Criminal Code, the provisions of which were set out in Chapter I.

## APPENDIX II

## DISCUSSION OF SECTION 3, ROBINSON-PATMAN ACT

As has already been pointed out, no cases have yet reached the courts under Section 498A or, later, Section 412. Nor has the section been the subject of public analysis by Canadian lawyers or economists. The situation is not greatly different in the United States where Section 3 of the Robinson-Patman Act is almost identical with our Section 412. The reason for the near identity of the two sections is that Section 3, which was originally introduced as an alternative to the Robinson-Patman Bill and was known as the Borah-Van Nuys Bill, was based, almost word for word, upon the Canadian legislation.[1] This Bill was first intended as a criminal statute, but in the end, after a confused legislative history, it was joined to the bill for which it was proposed as a substitute and together they were passed as an amendment to Section 2 of the Clayton Act. Section 3 of the Robinson-Patman Act has been little used in dealing with price discrimination in the United States; in fact it appears that only one[2] case, apart from civil actions for damages, has ever been adjudicated by the courts. However, there has been some discussion of the meaning and significance of this section of the Act by American writers and, in view of its similarity to Section 412, the following quotation from one of these articles may be of some interest.[3]

> "Section 3 contains three clauses which make three things unlawful. They are:
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> 1. To be a party to, or assist in, any transaction of sale, or contract to sell, which discriminates to his knowledge against competitors of the purchaser, in that any discount, rebate, allowance, or advertising service charge is granted to the purchaser over and above any

1. For those who are interested in following the legislative history of the Robinson-Patman Bill and the Borah-Van Nuys Bill, a detailed discussion is available in J. C. Palamountain, Jr., The Politics of Distribution, (Cambridge, Mass., 1955) pp. 220-33.

2. United States v. Safeway Stores, Incorporated, *et al.*, 1957 C.C.H. Trade Cases #68,770.

3. Quotation from a paper, "The Robinson-Patman Anti-Discrimination Act", by Thurlow M. Gordon, in a Symposium, Business and the Robinson-Patman Law, edited by Benjamin Werne, pp. 59-63.

discount, rebate, allowance, or advertising service charge available at the time of such transaction to said competitors in respect of a sale of goods of like grade, quality, and quantity.

2. To sell, or contract to sell, goods in any part of the United States at prices lower than those exacted by said person elsewhere in the United States for the purpose of destroying competition, or eliminating a competitor.

3. To sell, or contract to sell, goods at unreasonably low prices for the purpose of destroying competition or eliminating a competitor.

Discrimination under Section 3

The first of these clauses is the most dangerous. It prohibits discrimination in the most sweeping terms. None of the exceptions and safeguards contained in Section 1 are expressly made applicable to Section 3 except discounts based on grade, quality or quantity, and if literally construed, every other discount or price variation between competitors of any nature whatsoever would be prohibited regardless of either its purpose or effect. If the first clause of Section 3 were so interpreted, it would turn every private industry into a public utility - obligated like other public utilities to offer the same price to every customer. This probably cannot constitutionally be done in the case of private industries generally where no emergency or other special circumstances exist, such as existed in the rent case, Block v. Hirsh, 256 U.S. 135 (1921), the milk case, Nebbia v. New York, 291 U.S. 502 (1934) or (so at least some of the Justices thought) in the Guffey Act case, Carter v. Carter Coal Co., 56 S. Ct. 855 (1936). Moreover, unless the word 'discrimination' were given the liberal interpretation which we have referred to elsewhere, it would disrupt the whole existing system of production and distribution.

It would prevent the delivery of goods on long term contracts at prices either above or below those prevailing at the time of delivery. It would prevent the use of seasonal discounts. It would prevent the giving of lower prices even where necessary to meet competition. It might even forbid the giving of functional discounts to wholesalers and retailers and thus prevent the use of historic channels of marketing which are of great utility and have never given rise to any

tendency to monopoly or to other public injury.

A statute having such devastating consequences would constitute an unreasonable interference with freedom of contract, a confiscation of private property and a violation of the due process clause of the Constitution. And, finally, such an interpretation would compel an even greater degree of price uniformity than that which was so strongly criticized by opponents of the N.R.A. In order to avoid these consequences it seems probable that the word 'discriminate' as used in the first clause of Section 3 will be held to mean not merely difference in price - but a difference where there is a duty to treat all parties alike - under similar circumstances and conditions. In other words, the courts might read into the first clause of Section 3 a 'rule of reason' and hold that it prohibits only 'unreasonable' discriminations - i.e., discriminations between competitors under similar circumstances - without reasonable justification or excuse. This is substantially what the Supreme Court - interpreting the Sherman Act - did to the phrase 'every combination . . . in restraint of trade.' In this manner the court might hold that discrimination in Section 3 means substantially the same thing that is prohibited in Section 1, with which it is in _pari materia_.

## Local Price Cutting Under Section 3

The second clause of Section 3 merely prohibits local price cutting which was prohibited by the Clayton Act prior to the present law. It creates no new or special difficulty.

## Selling at Unreasonably Low Prices

The third clause, however, introduces a novel and exceedingly dangerous prohibition against selling at 'unreasonably low prices for the purpose of destroying competition, or eliminating a competitor.'

## What are Unreasonably Low Prices?

There is no standard whatever for determining what are unreasonably low prices. Does it mean below a reasonable profit? If so, what profit is reasonable? Does it mean substantially below the existing market if the requisite intent exists? Does it mean below cost to the seller; or below the cost to the injured competitor; or below a 'reasonable' cost such as the weighted average cost of the industry? Does it mean below a price that will enable the competitor to live?

Suppose that a particular seller bases his price on large volume but low margins - will he be blamed for injuring a competitor who has to secure a higher margin because of smaller volume? What consideration is to be given for the desperate competition existing in over-capacitied industries during the time of the depression - when everyone is selling below cost and is competing desperately for volume in order to survive? Must every seller disclose his costs to the world if the reasonableness of his prices is questioned? The difficulties which the N.R.A. encountered in endeavoring to operate under provisions of this character are indicative of the difficulties that will be encountered in attempting to apply this rule, especially in criminal cases.

Destroying Competition or Eliminating Competitors

Again, what is the meaning of the phrase

'for the purpose of destroying competition or eliminating a competitor.'?

If the necessary result of a sale is to injure a competitor, will the seller be held by implication of law to have intended the necessary and foreseeable consequences of his act - regardless of whether he actually intended them in fact? That rule has been applied in many cases under the anti-trust laws, Pattern v. U.S., 226 U.S. 525,541,543. Here, however, I believe that it will be necessary to show a specific intent - in the nature of actual 'malice.' There is a difference between competing to get business and competing to 'get' a competitor.

Suppose that one competitor is cutting prices badly while others are not. Can they prevent a second competitor from meeting that competition by pointing out that if he does so he will bring down the general price structure and injure or ruin them? I believe that they can not. He is not acting maliciously but only in self-defense. Even malice, however, is a somewhat metaphysical conception and men's motives are very often mixed. The normal object of every seller is to build up and increase his own business, which in many cases he can do only by taking business away from his competitor. Can he do this only if he is pure in heart and actuated by no motives of personal irritation or dislike? Suppose that one competitor has been engaged in particularly annoying practices - such as selling at a differential guaranteed to be always a certain amount below another

> competitor's price. Can the attacked seller drop his price in order to shake off this attack and to make the aggressive competitor behave? Is he to be condemned if he feels a natural impulse of retaliation as well as self-defense in doing so?"
>
> (pp. 59-63)

The following quotation also deals with the interpretation and significance of Section 3 of the Robinson-Patman Act. It is from an article entitled "The Meaning and Judicial Development of Section Three of the Robinson-Patman Act" which appeared in "A Symposium on the Robinson-Patman Act", Northwestern University Law Review, Volume 49, Number 2, May-June, 1954.

> "The meaning and coverage of Section 3 of the Robinson-Patman Act has been one of the controversial subjects of the antitrust laws. Designed originally as a criminal statute, it now appears to be available in civil damage suits. Its three clauses in large part duplicate the provisions of Section 2 of the Act without specific provision for the defenses available in that section. Because of the nature of its sanctions it has not been considered enforceable by the FTC, although its recent use in civil cases might logically throw some doubt on this generalization. After seventeen years, the wording of the section is only beginning to be interpreted by a number of relatively recent judicial decisions and it is questionable whether these interpretations have followed the original Congressional intent as to the scope of the section. So far there has been no Supreme Court or court of appeals decision on the more controversial aspects of the Act.
>
> . . .
>
> The Meaning of Section Three and What Constitutes a Violation
>
> With the way to civil suits opened to plaintiffs, it has become necessary more than ever to determine exactly what does constitute a violation of Section 3. This has not been easy for potential defendants. According to the language of the section, the following actions, providing they are in the course of commerce, constitute a violation: participating in a sale or contract to sell that to the participant's knowledge discriminates against

competitors of the purchaser;[23] selling goods at lower prices in one territory for the purpose of destroying competition or eliminating a competitor;[24] and selling goods at unreasonably low prices for the purpose of destroying competition or eliminating a competitor.[25]

Section 3 is obviously ambiguous in its provisions, so that it is necessary to see what scope the courts have given these three clauses. The decisions have centered around questions of 'like quantity,' 'unreasonably' low prices, permissible defenses, and burden of proof.

The first clause of the section prohibits discrimination only in sales of similar goods sold in like quantity. It was assumed that this meant what it seemed to say - two persons or corporate entities who bought like amounts. This assumption was strengthened by the senatorial debate which indicated quantity discounts were not to be severely curtailed.[26] But in Hipps Co. v. Bowman Dairy,[27] the defendant contended that since the Atlantic and Pacific Tea Company bought in much larger quantities than did the plaintiff, the section would not apply. The court interpreted the section to mean that if any one of the A. & P. stores that was in competition with the plaintiff bought similar quantities, the section did apply. This would

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23. This discrimination consists of any discount, rebate, allowance or advertising service charge granted to the purchaser and not available at the same time to competitors of the purchaser in respect of a sale of goods of like grade, quality and quantity. It will be noted that this does not prohibit quantity discounts, nor does it say that such practices as it prohibits must have an adverse effect on competition. Contracts to sell as well as actual sales are included.

24. This section apparently refers to competitors of the seller. Unlike other sections of the Act, it makes intent to destroy competition, rather than effect on competition, the test.

25. It will be noted that this section does not make any attempt to define what constitutes an unreasonably low price.

26. 80 CONG. REC. 6348, 8228 (1936).

27. 1950-51 CCH TRADE CASES #62,859 (N.D. Ill. 1951).

seem to be a clear expansion of the meaning of the clause and indicate that any quantity discount might conceivably be unlawful where the purchaser-plaintiff was in any sense competitive with a single unit of the other purchaser. There is no indication that the court limited its holding to a case where the units of a chain store actually placed their orders and were billed independently of other units and there is no discussion of this situation as differentiated from a case involving central purchasing.

Clause three of Section 3, referring to unreasonably low price, is perhaps potentially the most dangerous part of the statute to defendants. Interpreted broadly it would tend to eliminate free competition, since it is not restricted to price discrimination by a seller. Even if a seller reduces his price to everyone, he is still open under Section 3 to a charge of selling at an unreasonably low price in order to injure a competitor.

In Gordon, Wolf, Cowen Co. v. Independent Halvah and Candies,[28] the plaintiff was given the right to examine the records of the defendant to determine its cost of production and profits. The court impliedly felt that the answer to what constituted an 'unreasonably low price' would be found in cost and profit data. However, the court did not define just how these factors were to be used in determining what price would be considered unreasonably low.[29] A recent case indicates the defendant might show such factors as seasonal conditions, size of pack, and that he had reduced prices when in his judgment it appeared to be necessary in order to move the product. It was also indicated that a price set at less

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28. 9 F.R.D. 700 (S.D. N.Y. 1949). Defendant made the argument that if he was forced to disclose his cost and production figures it would result in his being forced to communicate trade secrets to his competitor. It would seem the fact that the plaintiff can go into any court and require such information makes it even more undesirable a procedure than the requiring of such data by an administrative organization.

29. F. & A. Ice Cream Co. v. Arden Farms, 98 F. Supp. 180 (S.D. Calif. 1951) (Costs, market conditions, level of profits were taken into consideration).

than cost might be unreasonably low.[30] It would seem from these cases that the courts maintain varying standards of what does constitute an unreasonably low price and that their attempts at definition have failed to clarify the meaning of the clause. Factors involved in the determination of price are so complex that a businessman may well not know whether his price is unreasonably low until he gets into court and is so informed.

The same ambiguity is present in determining the meaning of the words 'for the purpose of destroying competition.' The courts have not so far sufficiently defined the meaning of these words, nor does the Act or its legislative history indicate just what is meant. Every price cut, for whatever reason, is made in the last analysis for competitive reasons and every price cut of a large firm is going to hurt and destroy some competition furnished by marginal producers. How then, is it possible to differentiate between an intent legitimately to compete and a case where a price cut has the requisite intent to be prohibited by Section 3. The courts seem to have tacitly recognized this difficulty and have tended to make intent an objective, rather than a subjective element, because they have looked to the price-cutting act itself rather than the intent of the act to find liability.[31] In spite of this interpretation, the business man remains uncertain of his grounds and legitimate competition is discouraged. By use of an objective test, the requirement of a specific

30. Hershel California Fruit Products v. Hunt Foods, 111 F. Supp. 732 (N.D. Calif. 1953), motion to dismiss denied, 119 F. Supp. 603 (N.D. Calif. 1954).

31. E.g. See F. & A. Ice Cream Co. v. Arden Farms, 98 F. Supp. 180 (S.D. Calif. 1951).

intent is in effect eliminated from the statute.[32] It is submitted that since this is a criminal statute, there should be either a finding of actual subjective intent on the part of the defendant to destroy competition or eliminate a competitor, or a finding of a tendency toward monopoly.

It is clear that the statute itself does not set forth any defenses or justifications for price cutting. It would be doubtful under a strict construction that the defenses available in other sections of the Act are applicable to Section 3. Its legislative history gives no indication that the authors of the Act intended that the defenses should apply, but the courts, to a limited extent, have tended to read such justifications into the clause.[33] So far, however, there have been no cases holding cost justification available. It would appear anomalous that a number of defenses should be specifically available under Section 2 which is civil in nature and that none should be enumerated under Section 3 which provides criminal sanctions. Should the defenses under Section 2 be unavailable to defendants under Section 3, the constitutionality of Section 3 would be extremely doubtful.

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32. It would seem that if this clause is to stand, some workable definition of 'unreasonably low price' with intent to destroy competition should be established. It might be that it is possible to relate the price to actual sales below cost where no justification such as the perishability of the merchandise is involved. Some state statutes have been given such interpretation and upheld. It does not appear, however, that such was the legislative intent nor have any of the cases turned specifically on the 'below cost' issue. If it is not possible to give a definite meaning to the term 'unreasonably low price,' then it becomes necessary to make the finding of specific intent to destroy competition the key to illegality. But here again it seems that no standards have been established by Congress to guide the courts.

33. In Spencer v. Sun Oil Co., 94 F. Supp. 408 (D. Conn. 1950), defendant cut his prices sharply and undoubtedly hurt some of his competitors but received a judgment in his favor upon a showing that he did so in order to meet competition of certain other operators in the area. The defendant in the Hershel case, supra note 30, was permitted to show seasonal factors and the perishable quality of the product in justification of his sharp price reduction.

It appears that generally the burden of proof is on the plaintiff in Section 3 cases. Only one case has held otherwise. It is submitted that the majority view is preferable and that the plaintiff should be required to prove his damages instead of merely alleging a price differential. To require the defendant to carry the burden of proof would be unjust in view of the possibility of criminal penalties being imposed if violation of the section is established."

(pp. 285-92)

Canada. Restrictive Trade
Practices Commission
Report transmitting a
study of certain discrimina-
tory pricing practices in the
grocery trade made by the
Director of Investigation and
Research